Arkadin Managed Calls

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Speakers: Stéphane Boujnah, Giorgio Modica and Lee Hodgkinson

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Operator: Ladies and gentlemen, welcome to the Euronext Conference Call. I now hand over to Mr Stéphane Boujnah, CEO and Chairman of the Managing Board of Euronext. Sir, please go ahead.

Stéphane Boujnah: Hi, good morning everyone. This is Stéphane Boujnah speaking, and thank you very much for joining us on such short notice. With me on the call this morning is Giorgio Modica, Group CFO; and Lee Hodgkinson, Head of Markets and Global Sales. We are very delighted to present to you today that Euronext has made an irrevocable, all-cash offer to LCH Group and LSE Group to acquire 100% of the shares in LCH.Clearnet SA. Terms and conditions of this potential acquisition have been agreed.

This acquisition, or this potential acquisition, fully reflects the transformational ambitions embedded in our Agility for Growth Plan relayed in May. And if completed, this deal will strengthen the Euronext role at the heart of the Eurozone capital markets. This deal is subject to several conditions, including the completion of the merger between LSEG and Deutsche Börse. Therefore, it is important to highlight that Euronext remains absolutely committed to delivering the best long-term clearing options to our clients, irrespective of the completion of this acquisition announced this morning.

If you move to the transaction highlights, I would just remind everyone that Clearnet is, as you know, a leading multi-asset, Eurozone-based CCP, obviously serving Euronext's market for both derivatives and cash clearing. But in addition to that, Clearnet is also an important player in the CDS and fixed-income product spheres. This acquisition, therefore, is an opportunity for Euronext to secure long-term control of clearing activities for the Euronext market, both in cash and derivatives. But it is also an opportunity to deliver the Euronext ambitions to diversify its top line, adding new growing asset classes to Euronext's current portfolio, benefiting from regulatory tailwinds. And also, it clearly creates value for all shareholders, and for clients, and for all the markets where we operate in Continental Europe.

As mentioned, this transaction is conditional, open to various condition precedents[?]; the first, the completion of the merger between Deutsche Börse and LSEG which, as you know, remains under review by the European Commission and other regulators; condition of a favourable vote of the Euronext shareholders, although the support of our reference shareholders has been already fully secured; and other customary conditions, such as regulatory approvals, national antitrust approvals in France and Portugal, works council consultation process and various other consents. So, let me now pass the floor to Giorgio Modica, our Group CFO.

Giorgio Modica: Thanks Stéphane, and good morning to all of you. As you remember, during the Investor Day, we did set for ourselves some quite high standards for M&A, and clearly stated our ambition to secure a long-term solution for our clearing activity. Today we are confident that the potential acquisition we're presenting would meet those strict criteria, and would create value for Euronext shareholders and, more generally, to all of our stakeholders.

The price I gave for the acquisition is €510 million, and is based on Clearnet's June 2016 accounts. This price is subject to customary closing adjustment to reflect the increasing or decreasing of the capital, and includes excess capital. Just as a reminder, for the fiscal year 2015 the profit after tax and equity of Clearnet were €36 million and €301 million respectively.

Another element important to highlight is capital requirements. Clearnet is subject to multiple standards and regulations. As a CCP, it's subject to EMIR and supervised by AMF; as a credit institution, it's subject to CRD IV and supervised by ACPR; and as a derivative clearing organisation, it is supervised by CFTC. Now, among those requirements, EMIR represents the most stringent one, and such capital requirements amounted to €123 million as of June 2016. In this respect, I would like to highlight that although Clearnet is capitalised far above the EMIR requirements, the quantification of the excess capital actually available for distribution is always a very delicate matter. And in any event, any such distribution would need to be discussed and approved by relevant authorities.

Now, looking at the financial impact on Euronext: as anticipated, the deal would meet all the criteria set at the Investor Day. It would strengthen the business profile of the company and its revenue mix, with post-trade revenues representing, on a pro-forma basis, approximately 30% of Euronext revenues. In the first full-year post acquisition, 2018, the deal will be both double-digit EPS accretive and will generate a return on capital employed in excess of the cost of capital.

Moving now to synergies: since IPO, cost discipline has been a trademark for Euronext. In the context of the acquisition of Clearnet, we're confident in our ability to deliver €13 million of pre-tax gross cost synergies, leveraging on the intimate knowledge and strong links already existing between our two organisations. In addition, we believe that we could achieve a further €2 million of IT CAPEX savings that will progressively translate to higher EPS through a reduction of depreciation and amortisation. Restructuring costs are estimated at €40 million, while on the innovation front we believe that we will be able to deliver further revenue synergies from new products thanks to a new, stronger and more fluid relationship between the trading and clearing activities. Finally, this transaction could offer the opportunity to deploy part of Euronext's excess capital and optimise its financial structure.

We will fund the transaction using a mix of debt facilities and available cash. Pro-forma net leverage will reach 1.3 times. This is a net leverage last 12 months, as of June 2016, which is a conservative level still below the one of many of our peers, providing us with further flexibility to pursue other strategic initiatives. I would like to mention that this figure does not include any excess capital from Clearnet, i.e. consider the net cash position of Clearnet equal to zero. Let me pass now the floor to Lee for slide 3.

Lee Hodgkinson: Thank you Giorgio. As Stéphane already mentioned, this acquisition is part of our strategy to deliver clearing optionality. Clearnet already provides, of course, clearing services for our cash equities and derivatives markets, as well as clearing for fixed-income and CDS products, which are non-Euronext products. We believe the acquisition will strengthen the long-standing relationship between Euronext and Clearnet, and secure the strategic future of Clearnet within the Eurozone. It will create a compelling value proposition for customers based on capital efficiencies, product innovation and execution certainty.

Irrespective of the completion of the acquisition of Clearnet, we remain committed to delivering the best long-term solutions for our post-trade activities, in the interests of both our clients and our shareholders. And as you saw recently, we announced completion of our investment into EuroCCP, which we believe complements today's transaction, given the preferred clearing model we will pursue for cash equities. And as this acquisition is conditional, notably on the closing of the DB/LSE merger, we continue to explore alternatives for derivative clearing, as the contracts for both cash and derivatives we have with Clearnet expire at the end of 2018.

Over the page, you can see that Clearnet is connected to a wide range of trading sources, benefiting from a well-established clearing member community, and has access to numerous [inaudible] platforms, all creating a diversified portfolio of asset classes.

As I mentioned on the slide before, fixed income, CDS, listed derivatives, commodities and cash equities are all served across regulated markets for Euronext, as well as the OTC environment. A couple of points to note here: via listed derivatives and cash equities, Euronext markets accounted for close to half of Clearnet's revenues in 2015, making us the natural owner of this business. And importantly, Clearnet demonstrated its ability to increase, over time, its non-Euronext-related revenues, developing new and fast-growing asset classes and a client community.

On the next slide, I think we'd like to draw your attention to this opportunity for Euronext, as it adds two new and fast-growing asset classes, fixed income and CDS, which brings significant opportunities for us. In the fixed income space, we anticipate a strong growth potential from increasing regulatory pressures on banks to reduce their activity of risk warehousing, and further increase efficiency potential for clients. Clearnet's launching a number of initiatives, such as expanding its product classes to Bund and other European government bonds to generate revenue growth. It will also expand its client base to non-bank end users, allowing for greater netting opportunities for banks and the ability to capture currently uncleared bilateral repo trades.

In the CDS space, Clearnet provides European clients with a global and diversified product offering, including around 300 single European names and 200 US names, as well as a very robust and wide index coverage. In addition, Clearnet expects to continue developing a unique and differentiated product offering in this space, aimed at both dealers and clients in close support and partnership with the CDS banks. All of this opportunity is underpinned by the regulatory environment, which will be supportive of growth across the board. Giorgio.

Giorgio Modica: Thanks, Lee. And now in the next few slides, we will review financial highlights of Clearnet, the impact of the transaction on Euronext's revenues and capital structure and finally, before giving back the floor to Stéphane for his final remarks and before Q&A, we will review the timetable and next steps.

Let's start with slide 6. I would like to mention three main elements. Number one, the growth of gross income from €124 million to €137 million in 2015. Now, when looking at this growth, you should consider that gross income is net of the revenue-sharing agreement of Clearnet, both on CDS and derivatives. In 2013, there were no such revenue-sharing agreements, while in 2015 those components are accounted for nearly €27 million on a net basis. This element is not only important to assess the revenue growth but also the margin improvements, as displayed in the bottom right chart.

Number two: Clearnet's ability to diversify its revenue mix outside of the clearing of Euronext product. Fixed income and CDS not only account today for slightly more than 50% of Clearnet revenues, but also have been a key growth engine for the company.

Number three, operating expenses reduced over time. This is a business with high operating leverage. We are convinced that the positive tailwinds on CDS and fixed income, as highlighted by Lee, will provide further room for margin expansion.

On capital requirement, we already commented, and therefore I will move now to slide 7. This is a pretty self-explanatory slide, so just a few comments. Based on 2015 accounts, Euronext pro-forma revenues post-transaction would grow from €519 million to €627 million. Just a few words on this bridge. In the previous slide, we have seen that Clearnet gross income was €137 million. Now, this figure includes the net impact of the revenue-sharing agreement. The negative impact on revenues is €52 million, while on the positive side the contribution of Euronext to Clearnet's cost base is around €28 million. This explains why the delta between €519 million and €627 million is only €108 million, and not the €137 million that is looked at in the previous slide. The other element I would like to highlight on the slide is the increase in the post-trade revenues that would nearly double from 14% to 29%, again based on 2015 accounts.

Moving now to slide 8. At the Investor Day in May, we spent some time explaining why we wanted to retain some financial flexibility to pursue potentially value-accretive transactions. Today, thanks to this flexibility, we can finance the transactions with internal resources without any capital increase, and maintain a sufficient financial flexibility to look at other potential acquisitions going forward. On a pro forma basis, we would reach a net leverage below that of most of our peers – 1.3 times net leverage, as discussed – and we would maintain a very strong leverage profile. Despite we have the necessary facility in place, existing through the RCF and existing cash, in the next weeks and months we will explore ways to optimise the structuring of a financial package for this transaction.

Finally, and moving to slide 9, today clearly is the announcement date. Then going forward, we will start and complete, as customary in France, a consultation process with the works council. The Euronext EGM will be convened shortly, and will take place in mid-February. The reference shareholders of Euronext are supportive to the transaction, and will vote in favour of the deal. When this process is complete, the SPA will be signed, and this is expected to happen in the first quarter of 2017. The transaction, as mentioned by Stéphane, will be completed once the various conditions to completion has been satisfied, including the merger between DB and LSE. Completion will occur the same day as the DB/LSE merger, and this is expected to happen in the second quarter of 2017.

Now, let me thank all of you for your attention, and let me give back the floor to Stéphane for his final remarks.

Stéphane Boujnah: Yeah, thank you Giorgio. In summary, this acquisition will first strengthen long-term control of clearing for the Euronext markets, giving Euronext now full control of the value chain in our markets. Second, it will diversify significantly Euronext's revenue stream, and give us access to new and growing asset classes as underlined by Lee, namely fixed income and CDS in the Eurozone. Third, it will deliver attractive economics for Euronext shareholders, as indicated by Giorgio, with a significant level of synergies and double-digit earnings accretion in the first full year.

Let me underline that the Managing Board and the Supervisory Board of Euronext have unanimously approved the acquisition, and we are confident that you will be as excited as we are about this transaction. The reference shareholders of Euronext are also strong supporters of this deal, having announced that they will vote in favour of this transaction at the forthcoming EGM. Now, Giorgio, Lee and I shall be pleased to take your questions.

Operator: Ladies and gentlemen, the Q&A starts now. If you wish to ask a question, please press 01 on your telephone keypad, or send your questions through the webcast platform. Thank you.

The first question comes from Philip Middleton from Merrill Lynch. Please sir, go ahead.

Philip Middleton: Yeah, thanks very much, and *bonne année* to you all. I wondered, could you tell me a little bit about the weighted cost of capital you're assuming to get to your accretion – to get to your financial targets?

And secondly, maybe could you say a little bit more about how you're looking to broaden out what LCH SA does? I mean, would you be interested at some point, for example, in clearing other swaps products, other than CDS? How do you see the fixed income market evolving? Do you think this will make it easier to create listed futures products, things like that? Thank you.

Stéphane Boujnah: So, Giorgio will answer your question on cost of capital, and Lee will answer your question on outlook for growth.

Giorgio Modica: Yeah, so with respect to the cost of capital, I mean I would take the reference of the rate that we used to compute the impairment of our assets, which is mentioned in our annual accounts. And what I would say is that the rate that we're using to compute our computation is north of 8%.

Philip Middleton: Okay, thank you.

Stéphane Boujnah: Lee?

Lee Hodgkinson: Yeah, hi Philip. I think – we're very excited about it, right. I mean, Clearnet have developed a very strong footprint in the repo space and in CDS, and they've done that in very close partnership with the banks. And we that partnership as key to driving growth. And I think it will be far more straightforward for us to act as an agile solution provider for those banks in that area. So, we're very open to expanding the horizons of the Clearnet business as we bring our trading activities as part of the whole fleet, and also bringing the communities together.

So, if you think about the opportunities in the fixed-income world expanding to other European government bonds; if you think about the regulatory drive, this idea of sponsored membership to allow highly-rated non-bank lenders and borrowers access to the collateral liquidity pool by sponsor clearing;

the development of €GCPlus services and potentially listed products in partnerships with those banks: I think there are myriad opportunities. Clearnet's got a very strong team in the space of the repo and CDS world, and we're really looking forward to building all of that together. So, plenty of opportunity and supported by the regulatory environment, very close partnership with clients. I think it's a very bright future.

Philip Middleton: Thank you.

Operator: The next question comes from Arnaud Giblat from Exane. Please go ahead.

Arnaud Giblat: Yeah, good morning. Three quick questions please. Firstly, on surplus capital. So, you've clearly indicated that there is surplus capital available; I'm wondering if you could quantify it, and whether this capital is available to upstream back to the Group or if it will, for instance, remain ring-fenced in LCH? That's my first question.

Secondly, I'm wondering on the restructuring costs; so, you're saying €40 million of restructuring costs for €13 million of cost synergies. I'm quite surprised by that ratio. I mean, typically you'd expect around one times of restructuring cost in relation to the cost synergies. So, perhaps could you give us a bit more detail as to why the restructuring costs are so high, or perhaps there could be upside in cost synergies?

Thirdly, on the bank minority. So, currently the banks are minority holders to the tune of about – close enough to 36%, if I remember well, of the entire Group of LCH, so I understand that you are acquiring 100% of LCH here. Has that been approved by the bank minority holders themselves? Thank you.

Stéphane Boujnah: Okay, so Giorgio will answer your three questions.

Giorgio Modica: Yeah, so with respect to the first one which is related to the excess capital: again, clearly looking at opportunity to upstream the excess capital is something that we will clearly look at. But as anticipated, the quantification of the amount which would be actually available for distribution is a delicate matter, so it means that we will need to start, once the transaction will be completed, discussion with the relevant authority to have a better sense of how much we could actually extract. But it is our objective to use part of the cash which is today trapped into Clearnet.

With respect to your second question around the €40 million, there is one thing that you need to consider: that today there is a significant link between Clearnet SA and its mother company, and therefore the €40 million includes all the costs related to the carve-out of Clearnet from LCH Group, and all the cost that we will incur to integrate the company and to improve and ring-fence the IT platform. And so far, €40 million is the best estimate that we were able to come up with. And together with the €13 million, which is again our best estimate, it means that the day in which the acquisition will be completed, if it will be completed, we will sit down with the management of Clearnet to make a reassessment of those numbers. But today this is the best estimate we can provide you.

And with respect to your last question, you rightly pointed out the fact that there are minority shareholders at the level of the mother company of Clearnet SA, and clearly the transaction has been approved by them as well.

Arnaud Giblat: Thank you very much.

Operator: The next question comes from Owen Jones from Citi. Please go ahead.

Owen Jones: Hi, good morning. Thank you. A couple from me please. The revenue synergies you have mentioned, and as part of Lee's answer earlier in terms of product expansion: is it safe to assume that likely revenue synergies will be higher than the cost synergies that you have outlined? Presumably you can't yet give us a figure, but just an indication as to expectations would be useful.

Second question: with regards to ongoing revenues, given the mix now that you have presented to us this morning, do you anticipate having to put in place any contracts to ensure that those revenues reoccur post the transaction going through? So, any contracts or agreement similar to that that you have at the moment, with LSE for example? Thank you.

Stéphane Boujnah: Okay, Lee will answer your question.

Lee Hodgkinson: Yeah, it would just be useful if you could repeat that first question; it was a little bit difficult for me to hear, please.

Owen Jones: Okay, so it was just as to whether or not we can expect the revenue synergies to be higher than the cost synergies that you have outlined already?

Lee Hodgkinson: Yeah, I think – sorry, I'm just checking my notes. I think the answer to that is yes. We're looking for pretty strong development, I think, from the combination of the activities, as Stéphane pointed out earlier, giving us a much stronger capability and control over our existing business, particularly in the derivatives space. And we see very strong growth opportunities from expanding in the CDS and the fixed-income markets.

Owen Jones: Okay, and then the second question?

Lee Hodgkinson: The second question on transitional arrangements for contracts, right?

Owen Jones: Yes.

Lee Hodgkinson: Yeah, there are some contracts for transitional arrangements throughout the period of time, as we migrate from technology and those kinds of things. It's all pretty straightforward and have all been negotiated upfront.

Owen Jones: Okay, so just to clarify: in terms of the current revenue mix, there's a relatively significant contribution from the CDS clearing that LCH already does. So, can we assume that those revenues will reoccur in the next two to three years?

Lee Hodgkinson: I think that's a fair assumption, yeah.

Owen Jones: Okay, thank you.

Operator: The next question comes from John Detrixhe from Bloomberg News. Please go ahead.

John Detrixhe: Hello, thank you for taking my call. I just wondered if you could speak very briefly about the complementary nature between the EuroCCP stake and this, and just a little bit on how those work together, if possible?

Stéphane Boujnah: Okay, Lee?

Lee Hodgkinson: John, could you just repeat that question again; was it about €GC?

John Detrixhe: Yes, I was just wondering if you could talk a little bit about what you described as the complementary nature between the EuroCCP stake that was taken care of last month, and this deal now?

Lee Hodgkinson: Yeah, sure. I mean, look, I think in the cash world, as we described at our Investor Day in May last year, we see the provision of optionality to our clients as key in reducing the frictional costs of doing business with any cash market exchange, particularly us. And the important thing to remember is that there's no longer a one-size-fits-all framework in Europe for the clearing of cash equities. You know, some of the proprietary firms and larger investment banks want to use EuroCCP to reduce their frictional costs; some of the domestic players want to continue to use Clearnet. It all depends on the mix of business. So, we see this as being very complementary and completely aligned with our strategy of providing optionality in that space for our client base, which is probably the broadest and most diverse of any cash equities exchange in Europe. And we think that will help underpin the future success of our cash market business and help us retain market share. So, we see it as fully complementary.

John Detrixhe: Got it. Thank you very much.

Operator: The next question comes from Mike Werner from UBS. Please go ahead.

Mike Werner: Thank you. Two questions please, first one on your assumptions for the double-digit EPS accretion: what numbers are you using for the cost of debt financing for the debt that you'll be issuing for this deal?

And then the second question: with many of the clearing members currently having a financial stake in Clearnet, is there any concern that, with 100% acquisition of this business, some of those clearing members who will no longer have a stake in the clearing house – that the relationship between the clearing members and the clearing house may potentially weaken and open up the business to competition? Thank you.

Stéphane Boujnah: Okay, Giorgio will answer your first question and Lee the second one. Go ahead.

Giorgio Modica: I mean, with respect to your question based on our computation, the deal would be comfortably double-digit accretive. I mean, the numbers we're using for the cost of debt are around 1%, but even with the higher number it would still be double-digit EPS accretive. And I would leave the floor to Lee.

Lee Hodgkinson: Yeah, I understand the question; I mean, we believe very strongly that success in this business generally only comes through close alignment and partnership with the client base. And client-centricity is placed at the very core of the Euronext value proposition. As I mentioned earlier, Clearnet have done a fantastic job in building out a very powerful community in the CDS and fixed-income businesses. We will be following that model, we will be enhancing that model, and broadening it across all of our client base.

And so, I think that whilst we're cognisant of the point you raise, there's no reason that we can see that the relationships will be weakened, because we have every intention of continuing to be an agile solution provider, continuing to develop on the great footprint that Clearnet have created and continue in bringing out client footprints, together with Clearnet, to create more opportunities to meet the challenges that the client community are facing. So, we're very cognisant of the point you raise, but I think we're also very confident in our abilities in partnership with the client community to continue to grow.

Mike Werner: Thank you.

Operator: The next question comes from Archie van Riemsdijk from ABM Financial News. Please go ahead.

Archie van Riemsdijk: Yes, good morning. Well, most of my questions have been answered, actually. I have one question about the expectations for the capital requirements: do you have any views on how this will develop in the coming years, with new regulations coming up?

And on the availability of upstreaming of capital, do you have a view on what buffer you want to keep on top of the capital requirements? Thanks.

Giorgio Modica: I mean, addressing your two questions, the first one with respect to capital requirements: as you might remember, we did agree on a capital framework with our regulators, and this framework will remain in place after this acquisition, so we don’t see any major issue in this respect.

And then when it comes to your question with respect to the budget that we would like to keep: as I answered previously, this is a discussion that we would need to have together with the regulatory authorities to make a joint assessment of how much capital we might be in a position to repatriate after closing. So, this is an answer I cannot give you in this moment.

Archie van Riemsdijk: Okay, thank you.

Operator: The next question comes from Martin Price from Credit Suisse. Please go ahead.

Martin Price: Good morning. Most of my questions have been answered actually, but perhaps if I could just ask you a quick one on the LSE/Deutsche Börse merger, to the extent to which you’re prepared to answer this. But obviously, this transaction is contingent on the LSE/Deutsche Börse merger closing. I guess historically, you’ve been somewhat critical of aspects of that transaction: I was just wondering if you could share your latest thoughts on that deal, and where you see the key issues following the disposal of Clearnet? Thank you.

Stéphane Boujnah: Okay. Well, this acquisition presented to you this morning is conditional to the completion of the merger between London Stock Exchange and Deutsche Börse. As you know, this merger remains under review by the European Commission, and will be also examined by other regulators. So, Euronext cannot speculate as to whether or not the contemplated merger between LSE and DB will be approved or will not be approved. The role of the Euronext management team is to make sure that the interests of Euronext shareholders are well protected in any case. If this merger was to be approved by the European Commission and by other competent regulators, it is our conviction that the acquisition of Clearnet will create value for Euronext shareholders. If the DB/LSE merger is not approved by the European Commission or by other relevant and competent regulators, then we will be in a different environment.

Martin Price: Understood, that’s very clear. Thank you.

Operator: Ladies and gentlemen, just a reminder: in order to ask a question, please press 01 on your telephone keypad. Thank you.

Ladies and gentlemen, there are no further questions in the call. I now give back the floor to Mr Stéphane Boujnah. Please sir, go ahead.

Stéphane Boujnah: Well, thank you very much, and I wish you all a Happy New Year.