

Research Update:

Euronext Upgraded To 'BBB+' On Reduced Clearings And Settlement Risk And Continued Deleveraging; Outlook Stable

February 9, 2023

Overview

- The change in Euronext Clearing's investment policy--to deposit almost all the cash margins posted by clearing members at the European Central Bank (ECB) rather than investing in European sovereign debt--has meaningfully reduced risk for Euronext, in our view.
- Euronext's 2022 performance was broadly in line with our expectations when adjusting for the one-off loss in its clearing treasury portfolio linked to the derisking described above. We expect that financial leverage will continue trending downward, absent any large debt-financed acquisition, and that at end-2023 adjusted debt to EBITDA and adjusted funds from operations (FFO) to debt will reach 2.5x and 30%, respectively.
- At the same time, we expect Euronext will successfully execute its strategic plan, supporting its competitive position.
- We therefore raised our long-term ratings on Euronext and its unsecured debt to 'BBB+' from 'BBB', and affirmed the 'A-2' short-term issuer credit rating.
- The stable outlook reflects our expectation that Euronext will post organic EBITDA growth of about 3%-5% and maintain broadly flat margins in the next two years. It also reflects that financial leverage could decrease further, but we are mindful that this could swiftly change if Euronext acts on merger and acquisition (M&A) opportunities.

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Rating Action Rationale

Clearing and settlement risks have abated for Euronext following revision of Euronext

Clearing's treasury portfolio investment policy. In 2022, Euronext Clearing revised its investment policy to invest almost all the cash margins posted by clearing members at the ECB. We understand the clearinghouse sold its long-dated sovereign bonds, leading to a one-off loss of close to €49 million, and that short-dated bonds will fully run-off by May 2023. This is a significant shift from its previous approach of investing a sizable portion of cash margins in Italian and other

European sovereigns' debt. We saw the previous investment policy as a credit weakness relative to clearinghouses that invest in instruments with very high credit quality. Following the revision, we believe Euronext's clearing and settlement risk--that is, its ability to protect itself from loss in the event of member default--is now more in line with that of the other major clearinghouses that we surveil.

We continue to see some moderate relative strengths and weaknesses in Euronext Clearing's clearing risk profile relative to that of peers. For example, we view its members' creditworthiness as somewhat weaker than that of many other surveilled peers, although many of its largest members are large, highly rated international financial institutions. We also see membership as a little more concentrated than that of most peers--for example, the top-five clearing members account for about 70% of total initial margins, whereas the peer average is in the 50%-60% range. Still, we see Euronext Clearing's thoughtful consideration of related risks; notably, its modelling suggests that it would remain resilient from a credit and liquidity standpoint even if more than the two riskiest clearing members defaulted (that is, it exceeds the "cover two" approach that is standard among peers). Looking ahead, if Euronext Clearing is successful in attracting clearing flows from across Euronext's markets, this could improve the average creditworthiness of its membership and lower concentration, but at the same time the clearinghouse could move high credit and liquidity sizing closer toward the "cover two" approach.

We expect Euronext will continue its deleveraging over the next two years, absent material

M&A. In 2022, Euronext further deleveraged from the elevated level that followed the acquisition of Borsa Italiana (BI), supported by its solid performance and cash accumulation. We calculate that at end-2022 its S&P Global Ratings-adjusted debt to EBITDA reduced to 3.0x and FFO to debt improved to 23%; from 3.6x and 19%, respectively, at end-2021. Our adjusted EBITDA includes the €49 million one-off loss on the clearing treasury portfolio. We expect these metrics will improve further, with debt to EBITDA at about 2.0x-2.2x and FFO to debt close to 35% by end-2024. We could revise these projections in time, because trading volumes are uncertain by nature and if Euronext spends more on bolt-on acquisitions than we currently anticipate, but in our base case we believe the group will deliver further material deleveraging over the next two years. With total gross debt of close to €3 billion and the next bond maturing only in 2025, we expect this deleveraging to be the result of high cash accumulation on the balance sheet, unless Euronext undertakes some kind of liability management exercise. Moreover, as for peers, our projections do not include any large but unannounced acquisitions, since dealmaking is inherently unpredictable, but we remain mindful that Euronext has a track record of substantial inorganic growth.

Euronext's 2024 strategic plan will consolidate its competitive position if achieved. Euronext's updated strategic roadmap shared in November 2021 sets five strategic priorities: leverage its integrated value chain, expand its central securities depository activities, consolidate its leadership in Europe, empower sustainable finance, and execute value-generative M&A. With BI acquisition, the group expanded its revenue streams and added clearing and settlement capability through Cassa di Compensazione e Garanzia (now Euronext Clearing). Notionally, this completes its trade value chain from listing, to trading, to clearing and settlement, and other post-trade services. Euronext expects to gain market share in the clearing business and add related new revenue as it announced activating break clauses in its clearing contracts with LCH S.A. We believe this to be a challenging target and a long process given the incumbent positions of Eurex Clearing and LCH. Still, we consider management's announced financial targets on total revenue (+3% to +4% compound annual growth rate [CAGR] by 2024) and EBITDA (+5% to +6% CAGR by 2024) to be reachable in light of the 2022 performance (revenue +9% and EBITDA +8%, largely

supported by the full-year effect of BI consolidation and but also partly offset the one-off loss of trading portfolio). We also view Euronext as prudent in its announced synergy targets given that it overdelivered on past deals (Dublin, Oslo Bors, and VP Securities) and efficiency programs. Furthermore, Euronext is progressing well on the BI integration, in line with its original plan. It completed its data center migration in June 2022 and is on track to migrate the Italian clearing business to the Optiq platform in 2023, with the first phase of migration of cash equities and exchange traded funds expected in March 2023. As a result, we estimate that Euronext's EBITDA margin will remain above 55% in 2023 (estimated at 56.5% in 2022) despite further one-off costs linked to the BI integration and the development of Euronext Clearing.

Outlook

The stable outlook reflects our expectation that Euronext will post organic EBITDA growth of about 3%-5% and maintain broadly flat margins in the next two years. It also reflects that financial leverage could decrease further, but we are mindful that this could swiftly change if Euronext acts on M&A opportunities.

Downside scenario

We could downgrade Euronext if a large debt-fueled acquisition materially worsens the company's financial risk profile, with adjusted debt to EBITDA above 3.5x and adjusted FFO to debt below 23%. We could also lower the ratings if we see material risk-management deficiencies emerge as Euronext expands its clearing services.

Upside scenario

We consider an upgrade to be remote within our two-year outlook horizon. We could upgrade Euronext if we saw a structurally lower leverage appetite, with adjusted debt to EBITDA below 2.5x and adjusted FFO to debt above 35%, both on a sustainable basis and considering potential large acquisitions, demonstrating a sustained prudent financial policy. Any upgrade would also need to take into account relativities with currently higher-rated peers.

Company Description

Euronext is the operating holding company of a leading pan-European financial market infrastructure (FMI) group that operates securities and derivatives exchanges in Amsterdam, Brussels, Dublin, Lisbon, Oslo, Milan, and Paris. The group operates listing and trading venues for cash and derivative products, and provides market data, indices, technological solutions, clearing, custody and settlement services. It is 23.8%-owned by a consortium of reference shareholders comprising Euroclear SA/NV, Caisse des Dépôts et Consignations, Italian CDP Equity, and leading banks from its main national markets; but is otherwise widely held.

Our Base-Case Scenario

Assumptions

In our base case for 2023 and 2024, we assume:

- Solid franchises across key trends in FMI;
- Sound organic growth prospects amid continued volatility. Revenue growth of about 5%-7% in 2023 based on 2022 revenues, including the one-off treasury loss, and 2%-4% in 2024.
- An EBITDA margin of about 55%-57%, including costs to achieve synergies across the group.
- Solid cash flow and cash generation.
- No transformative M&A, but we include a conservative yearly €80 million-€120 million budget for bolt-on acquisitions given Euronext's track record.
- Net debt, including liabilities arising from right-of-use assets, approaching €1.4 billion-€1.6 billion by end-2024.

Solid underlying revenue growth will reflect some favorable tailwinds for Euronext in 2023--notably a decent forecast for continued volatility--alongside good structural drivers in core services, such as sustainable finance listings. The fall in the EBITDA margin from the current 57% reflects one-off transaction costs in 2023 and 2024, including those to achieve synergies with BI. We expect this to return toward 57%-58% thereafter, excluding any M&A-related costs.

Key metrics

Euronext N.V.--S&P Global Ratings-Adjusted Key Metrics

	2021	2022	2023f	2024f
EBITDA margin (%)	57	57	55-56	56-57
Net debt to EBITDA (x)	3.6*	3	2.4-2.6	2.0-2.2
Funds from operations to debt (%)	19*	23	29-31	34-36

f--Forecast. *3.2x and 22.5% pro forma full year of BI in 2021.

Ratings Score Snapshot

Euronext N.V. -- Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Positive/A-2
Business risk	Strong	Strong
Country risk	Low	Low
Industry risk	Low	Low
Competitive position	Strong	Strong
Financial risk	Intermediate	Intermediate
Cash flow/Leverage	Intermediate	Intermediate
Preliminary anchor	bbb+	bbb+
Clearing and settlement risk	0	(-1)
Anchor	bbb+	bbb
Modifiers	0	0
Diversification/Portfolio effect	Neutral (0)	Neutral (0)
Capital structure	Neutral (0)	Neutral (0)
Liquidity	Strong (0)	Strong (0)
Financial policy	Neutral (0)	Neutral (0)
Management and governance	Satisfactory (0)	Satisfactory (0)
Comparable rating analysis	Neutral (0)	Neutral (0)
Group credit profile	bbb+	bbb
Structural subordination	None	None

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Financial Institutions | General: Issue Credit Rating Methodology For Nonbank Financial Services Companies, Dec. 9, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings:

Methodology And Assumptions, Nov. 20, 2013

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- FMI's Will Ride Out Economic Gloom, But Beware Financial Stability Risks, Jan. 31, 2023

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Upgraded

	To	From
Euronext N.V.		
Senior Unsecured	BBB+	BBB

Upgraded; Outlook Action; Ratings Affirmed

	To	From
Euronext N.V.		
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Positive/A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings

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