Euronext - Educational Session on Cash equity trading

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Operator: Hello, and welcome to the Educational Session on Cash equity trading conference call. Please note this call is being recorded, and for the duration of the call, your lines will be on listen only. However, you will have the opportunity to ask question at the end of the call. This can be done by pressing star one on your telephone keypad.

I will now hand you over to your host, Mr Giorgio Modica, Euronext CFO, and Mr Simon Gallagher, Head of Cash and Derivatives to begin today's conference. Thank you.

Aurélie Cohen: Hello. Good afternoon, everybody. So this is Aurélie Cohen, Chief Communication and Investor Relations Officer. Thank you very much for joining this call this afternoon. Just a quick word as an introduction. So this is an educational session. There will be no specific announcement. The idea is really to walk you through our cash equity business. There will be no forward-looking statements. So now disclaimers have been done. You can find the slides on our website.

Clément is sending to you also the presentation for those who haven't it. And you can find the replay of this session on our website as well.

So I now leave the floor to Giorgio Modica for the start of this presentation. Thank you.

Giorgio Modica: Thank you very much, Aurélie, and good afternoon to everyone. I would like you to welcome you and thank you for attending this event. With me, Simon Gallagher, Head of Cash and Derivative at Euronext will be the main speaker this afternoon.

As a matter of introduction, the idea of this call comes from the many questions about our cash equity trading business we received during our last roadshow through Europe and the US. We met some of you and in total over 100 investors.

On average, we spend, I would say, between 50% and two thirds of the time of the meeting discussing of a business that today represents only 20% of our top line. And from this experience comes the idea of this call with you today, investors and analysts, to deep dive into our cash equity business, its dynamic and trends.

At the end of the presentation, you will have a Q&A session to address your remaining questions or concern. As Aurélie said, before moving to the presentation as well, I would like to do a brief reminder. This call is not aimed at providing you with financial targets nor the volume for next quarter, as well the average fees for next year. This is an opportunity to know about the Euronext and ask question directly to Simon, who leads our efforts in the cash and derivative businesses.

After this brief disclaimer and before giving the floor to Simon, I will cover a few slides starting from slide four. As we said today, we will discuss about cash equity trading. But I wanted to take this opportunity, the opportunity to speak with this audience to say that today Euronext is much more than its cash trading business. Euronext has evolved significantly from the cash equity exchange it was at IPO.

Today, 55% of our revenues are non-volume related. And out of the 45% of volume-related revenues, cash equity trading only represents 20%. During the last year, Euronext transform itself into a fully integrated exchange and achieved significant diversification of its revenues away from cash equity trading.

Furthermore, Euronext is not only diversified into non-volume related activity, but also within its trading business. Different businesses we are operating in trading have no or limited correlation one with the other. This provides the diversification and resilience.

Moving to slide five. Many of the questions we received during the roadshow were aimed at assessing the resilience of Euronext business mix, any sensitivity to volumes and market levels. The message I would like to pass is that our business model is more resilient than many things. And let me give you a few examples.

First, we operate several businesses with no correlation with volumes nor market levels. Advanced Data Services, Corporate Services, Investor Services and Technology Solutions are examples of those.

Second, with respect to our volume-related business, our trading activity, as we said, cover different asset classes such as FX, power derivatives and fixed income. This provides diversification.

Furthermore, our variable listing fees are not recognised when invoiced to clients but over time, according to the principle IFRS 15. This smoothens fluctuation of our listing revenues in the P&L.

My third and last point I wanted to cover is that we have businesses which are impacted by market levels. However, it is important to highlight that this relationship is not linear. And I would like to make a few examples.

The first one is that the annual fees of our listing business are capped, and those caps will partially offset potential loss of revenues linked to reduced market levels. To say it differently, in the last year, the high level of the market did not fully translate into higher revenues in our P&L because of those caps. By the same token, a reduction of market level will not translate proportionately into a reduction of revenues.

Another example is our CSD business. The stock of assets under custody is the main driver of revenues for our CSD business. However, in our assets under custody, debt securities, which account for two thirds of the total are considered at par value, therefore, not impacted by changes of market levels.

I would like to conclude saying that Euronext, it's for sure a market infrastructure, but the structure of our revenue has a lower beta with respect to the one of the markets we operate.

And then let's get into the most important part of this call. And I would give the floor now to Simon.

Simon Gallagher: Thank you, Giorgio, and good afternoon, everyone. It's a pleasure to speak to you today.

So moving to slide seven, I'd like to introduce this session with a very, very simple slide, but we think it's a powerful slide. And this is what we can reduce the business model of our core cash equities trading business to. The mission of us as a team is to maximise the product of volumes, market share and yield.

And behind each of these KPIs, obviously, as we'll see, as we go through the presentation, there are many more KPIs and segmentation strategies, but allow me to just talk through at a high level by way of introduction through each of these.

And so the first variable in the business model is very obvious, it's the size of the pie. And these are the volumes in lit trading on Euronext listed securities across Europe. And here, you have the figures for the second quarter this year.

Volumes are notoriously difficult to predict. But we know that volumes tend to be correlated to a number of things. The first is GDP growth of the countries we operate in. Second, very – another correlation is the corporate performance of the listed stocks, the earnings per share and the projected earnings per share of our listed securities.

And third, the stock market performance itself. So how the indices are performing. And layered on top of this, of course, are asset allocation strategies, which are highly linked to any monetary fiscal stimulus or policies.

If we move to the second and third variables on this chart, this is where I will concentrate most of my presentation today. And it's about this crucial trade-off and management between yield and market share.

And now, I would like to make four introductory points before moving to the next slide. The first is that Euronext benefits from our diversity of flow in terms of types of participants on this market, which is unique, and which is not present on competing MTFs, and we'll talk about this later.

Second, we will spend a lot of time today talking about the very detailed and granular segmentation strategy that Euronext has applied on this diversity of flow. We will see that this is all about optimising fees versus market share in the most granular manner we can, whilst obviously respecting all the relevant regulatory frameworks, and most interestingly, reaching upstream in the value chain to the customers beyond the big sell side gateways.

Thirdly, we will spend a lot of time talking about liquidity and market quality. And fourthly and most importantly, a new access in our commercial strategy, we will talk about the need and the effort we have been making in recent weeks, and which we will intensify going forward to sell the quality of execution of Euronext – available on Euronext order book to intermediaries and to end customers such as yourselves, the investors on this call today.

So moving to slide eight. Now let's take a step back and look at the performance of Euronext since the IPO on these two crucial KPIs we operate under, market share and yield. And so the green line on the top of this chart is the evolution of the market share since June 2014. And here, we can identify four key phrases as we comment – phases as we comment the evolution.

And so broadly speaking, prior to 2018, market share on Euronext and other primary markets, oscillated between 60-65%. And then post 2018, we saw an uplift of market share on Euronext, primarily through the implementation of revised liquidity schemes. And then, as we all knew – as we all know, we experienced an extraordinary period of volatility during the COVID crisis, where primary markets, including Euronext all benefited from a flight to quality as real economy investors sought to execute on safe and transparent markets.

And the fourth phase in the market share, especially since the start of the year, we are seeing a return of market share numbers to the pre-COVID era as markets readjust once more.

And now a few comments on the yield evolution. The yield we are showing you here is the Euronext legacy yield, excluding Borsa Italiana yield, which would provide a dilutive effect.

From March next year, the Borsa Italiana equities business will be invoiced under a new Euronext fee grid, so we can include those numbers from that point.

But I'd like to highlight two things, which have helped us increase yield since the IPO. The first is the intelligent onboarding of new markets and the inclusion of those markets under various Euronext pricing schemes. The most recent ones are Oslo Børs and Dublin, where we saw significant yield uplift. Please note that Milan, from March next year, will be included on the various fee grids.

The second which is a more general theme I would like to talk about during this presentation from 2016, the Group has pursued a very intensive segmentation strategy to optimise market quality and extract maximum yield from the underlying flows. The recent dip you see in the most recent period is very much correlated to the very high volumes we saw in quarter one, following the Russian invasion of Ukraine as volumes go through the lower price higher volume tiers.

Moving to slide nine, I mentioned that Euronext is a safe haven during volatile times and particularly during COVID. On the left-hand chart, you have the VIX volatility index. And it can be clearly demonstrated that Euronext in terms of volumes benefited the most from this uptick in volatility.

And on the right-hand chart, in this scatter chart, it clearly demonstrates over the last two years, that when volatility is high, spreads are the lowest on Euronext. I needed just to extractions from some quantitative research we have published in recent times.

Moving to slide 10. Now on the next two slides, I would like us to dig into a bit deeper into what we mean when we talk about a segmentation strategy. And so on this chart, you have, what I would say, is a simplified version of the segmentation strategy we have applied on our cash equities business. I say simplified because behind this chart, there are 20 discrete pricing boxes and pricing points where we target specific customer groups. But allow me to briefly talk through the three main ones on this slide.

We'll start with the middle box, which are the regional banks and brokers. I mentioned earlier at the start of this presentation that the diversity of flow and the presence of real economy flow on Euronext order book was a key differentiator. So Euronext has still connected to its markets, the regional banks and brokers the key intermediaries in each of the seven markets we operate in, and crucially, we have retail present.

And so for each of these local broker groups. In one instance, we offer local fee schemes in each of the markets we operate in. The purpose of these local fee schemes is to keep the local brokers and liquidity champions on our market economically competitive with respect to the larger investment banks. And this has been implemented with great success in Oslo, in Dublin and the same policy will be implemented in Milan from March next year.

Secondly, Euronext is the only exchange in Europe to be able to identify and flag the retail business being executed on its market. This is done through our best of book scheme to which virtually all retail brokers are connected, and which again is subject to a specific fee theme and a one-stop shop best execution service. So this is all about keeping quality flows connected to Euronext and providing liquidity for the others.

Beneath the local brokers, you have the box, electronic liquidity providers and quant funds. As we know, these are some of the most fee sensitive players on the market. And again, here we have a number of fee policies available which optimise the fee market quality trade-off for each of these firms, depending if they're direct members, indirect members or whether they want to participate in the more formal liquidity schemes I'll come to later.

And so these are the really the two key ingredients of the market quality, which is in turn then provided to the big global brokers, the big global intermediaries, who will account for the majority of flows coming to our market. The quality of execution provided by this mix enables us to price for value to these customers and to extract maximum yield from the franchise.

Moving to the next slide. So in a nutshell, that was the segmentation strategy of Euronext. Of course, this segmentation strategy does not fit statically. It fits in a value chain, which is evolving rapidly. And so obviously, and it's the same with all primary markets, the big global brokers are the main gateways to trading on exchanges such as ourselves.

But behind these global brokers, things are moving fast and quickly. Asset managers and quant hedge funds are becoming more and more aware of the quality of execution that needs to be delivered by execution venues and how that can be actively demonstrated.

As an example of this, a couple of years ago, Euronext implemented one scheme you here on – you see here on the right-hand side called Pack Omega. We started off with two clients. And here, we are aiming for electronic hedge funds who do not want to connect directly to the exchange, but with whom we can generate price volume elasticity. Under Pack Omega, we have a direct invoicing relationship with the underlying firm, while the underlying firm still goes through the global broker for their – all their regulatory compliance and technical connectivity.

This scheme has generated significant upside in volumes. And the firms in the scheme have grown from two, two years ago, to ten today, and they account for a material part of the volumes coming through the central order book.

If we go to slide 12. And we'll talk about something called the Supplemental Liquidity Scheme. This scheme is the most effective tool in our arsenal to manage market share and yield. This scheme has been the cornerstone of our liquidity strategy for the last ten years. It was pioneering in Europe when it was introduced. It has been regularly adjusted since then, and very flatteringly, it is slowly becoming copied and emulated by peer primary markets.

But in short, in this scheme is contained a group of electronic liquidity providers who are subject to some of the most stringent requirements in terms of quality of execution and liquidity provision in Europe.

In return for playing the game, this group of firms receives rebates and incentives in terms of fees. This scheme is regularly revised and it will be revised in the coming weeks as we adjust to the recent changes in liquidity dynamics in Europe. We will not say any more on this point at this stage.

Moving to slide 13. I mentioned previously in my presentation, the importance of providing price formation, quality of execution to our intermediaries and end customers. And on this chart, which is very, very simple, a very powerful message is conveyed.

In terms of EBBO setting, what this means is the amount of times a new price on our stocks is set at Euronext. And so over two thirds of the time when there's a price change in – on our stocks, it happens here on Euronext. Why is that? Is because we have the deepest pool of liquidity and price formation occurs on Euronext. These prices are then mirrored and copied by LPs on the competing MTFs.

On the horizontal axis, you have another important measure of liquidity, which is the amount of liquidity available at the top of the book at the best bid and offer. And here, you can see the depth of liquidity available at Euronext, which is two to three times that available on a competing MTF.

Let's move to slide 14, which we believe carries an important message. We know that explicit trading fees to the concrete trading commissions charged by trading venues vary between primary market and between primary markets and MTFs. But this is only one part of a far more complex and richer story. The rest of the cost story has to include and does include what we call implicit execution costs. And this is directly linked to the quality of execution available in the market. And this can be measured through various metrics, spreads, liquidity, reversion, mark outs. And on all of these metrics, Euronext is demonstrably empirically better than the competitors.

These facts are being told out loud now, very clearly to intermediaries, not only to intermediaries and brokers, but also to investors such as yourselves listening to this call today. This story of best execution is going to be a key part of our commercial strategy going forward.

And on the next slide, you just see a few examples of some of the quantitative research we have been producing over the last few months. This is produced by a new quantitative research department set up at Euronext last year. And the mission of this department is to sell and explain to intermediaries, but above all, to end buy side customers that the quality of execution received on Euronext, the implicit trading costs received on Euronext are far lower than our competitors.

The evidence provided in these reports is all publicly available. It is publicly reproducible. And many of these reports will shortly be submitted to academic peer reviewed journals.

And so I'll conclude on this point. Demonstrating best execution of Euronext is going to be a key part of our strategy going forward.

And so this brings us to near the end of our presentation. Now I'd like to leave you with three points.

First, by any empirical measure, Euronext remains by far the point of price formation for our securities. And we see nothing in the coming future which will change this.

Second, more than any other market in Europe, Euronext disposes of a granular toolbox of LP schemes or pricing schemes to manage this very subtle trade-off between yield and market share, all based on a great diversity of flow on our markets.

And third, we are all asking ourselves questions about volumes next year. But relative to alternative venues, the Euronext business model for cash equities, we believe, is far more robust to any downturn in trading volumes over the coming years.

And so thank you for your attention. That was my brief presentation. And now Aurélie and Giorgio, I believe will open up for questions.

Questions and Answers

Operator: As a reminder, if you would like to ask a question, please press star one now on your telephone keypad. To withdraw your question, please press star two. The first question comes from the line of Mike Werner calling from UBS. Please go ahead.

Mike Werner (UBS): Thank you very much for the presentation. I was just wondering if you could provide a little bit of information with regards to closing auctions, and how important or what portion of volumes that accounts for Euronext's cash equity trading, perhaps what portion of revenues. And how you see – I suspect you guys have a very commanding market share in that space. And just wondering how you see that progressing in the coming years. Thank you.

Giorgio Modica: Thank you very much for the question. Simon will answer that question.

Simon Gallagher: Thank you for the question. So in terms of volumes, as we know, over the last six, seven years, there's been a big rise in closing auction volumes as passive management techniques have grown across Europe. But I think before the COVID period, we've seen this stabilising and it's roughly a third of trading volumes of a typical trading day.

In terms of market share, there are no viable closing auction mechanisms operated by the MTF. You're absolutely right in terms of market share, the situation could be described as the word you said.

And in terms of outlook for closing auctions, there have been many, many, many attempts now to try and fragment the closing auction. But there's one fundamental truth here, the market will not tolerate to closing prices. And so this has meant that the attempts to try and shift closing auction or reduce size matching mechanism, which imports the price from a primary market. But to this day, the closing auction remains a very unique and very elegant point of price formation. And the quality of execution provided in this single magic five-minute window is second to none.

The average trade sizes are ten times compared to what they are in the continuous session. So we remain very confident that this will remain so because it's very much appreciated by our – the end and buy side investors and are listed firms.

Mike Werner: Thank you, Simon. It's very helpful.

Operator: The next question comes from the line of Ian White calling from Autonomous Research. Please go ahead.

Ian White (Autonomous Research): Hi. Thanks for doing the presentation. Just want to follow up from my side, please. I think you've set out albeit a reasonably high level the sort of detail that you go into, in order to sort of segment pricing for different end users. Can you just set out for us, please, what it is that would make this incredibly difficult or impossible for a competitor to copy just in terms of segmenting the pricing and through discriminating between different end users? Why is that not viable for a competing MTF to do that, please, compete on that basis? Thank you.

Simon Gallagher: Absolutely.

Giorgio Modica: Thank you very much for that – yeah. Go ahead.

Simon Gallagher: Sorry, Giorgio. Yeah, so the actual – there's no rocket science behind segmenting customer groups. But you need a basis, and you need customer groups to segment. And to this day, the variety of flow that exists on Euronext, and let's be honest, on a lot of other primary markets, is far more diversified than that which is available on the competing MTFs today.

So in all modesty, anyone can segment and be clever about that. But it's the installed base that I believe you're segmenting on top of and how clever you are in segmenting the market. You can cut it hundreds of ways between the geography, the – where the end flow is coming from, the retail institutional, and especially for the different types of electronic liquidity providers that can be a very innovative space.

And the more liquid your market, the more flow you can attract to the market as well. So sorry, that's a long answer to a short question. But I think it's very much to do with the installed base of your customer.

Ian White: Yeah. That made sense. Thank you.

Operator: The next question comes from the line of Arnaud Giblat calling from BNP Paribas Exane. Please go ahead.

Arnaud Giblat (Exane BNP Paribas): Yes. Thanks for the presentation. A quick one on retail and market share on retail investors here, because I think it had a big impact on the yield in 2020-2021, and has been – the share price has been coming off. Could you maybe size up what impact that has had and what the outlook is in your view for retail market share? Thank you.

Simon Gallagher: Yeah, so I think during the COVID crisis, we all saw a huge, huge uplift in retail flow coming to our markets, which you're perfectly right, that was yield accretive. The one thing we're witnessing in the markets with the Ukraine crisis is that retail is just not participating in these volatility events to the same extent they did before.

What we can say is that, in terms of proportion, the amount of retail trades on Euronext is still strong, it’s gone back to slightly higher than pre-COVID levels, around 4-5%, which is directly identified retail broker flow. There's obviously a lot more coming through indirectly, which we can't identify.

And just a quick note on the Italian market, which we're incredibly excited about bringing on to Optiq in March next year. The retail flow participating in the Italian market is really something very special. It's around 15%. And it's a – quantitative analysis of the impact of that retail flow in price formation is very, very, very promising. So this is a key segment for us and certainly it's gone off the boil a little bit but it still remains stable and there's a lot more to come when Italy comes on board in March next year with that very vibrant retail market.

Arnaud Giblat: Okay, thank you.

Operator: The next question comes from the line of Andrew Coombs calling from Citi. Please go ahead.

Andrew Coombs (Citi): Hi. Good afternoon. Thanks for doing this session. I guess, you just touched upon it, the migration on to Optiq for Borsa Italiana. I know previously, when this has been stuff discussed, we've talked about kind of 4 basis points dilution just from the merger with Borsa Italiana given the lower blended yield. As and when you do the migration, presumably there will be an effort to roll out a similar diversified segmented pricing strategy across Borsa Italiana. What does that mean from the perspective of the yield, but also the perspective of volumes going forward in your view?

Giorgio Modica: Yeah, I will take the question. I guess that the – Simon presented the slide in which it clearly addresses the different category and families of fees. The idea is clearly to roll out similar schemes in Italy as well. And unfortunately, we cannot elaborate further because, clearly, we cannot set target as we said in this call for the average fee for next year. But it's fair to say that we expect an uplift in the average basis point after the migration to Optiq.

Andrew Coombs: Just to follow that rationale, I think previously you've talked about kind of 51 to 52 bps being the standalone Euronext blended yield with Borsa Italiana and, I think, you talked about 47 basis points to 48 basis points. Once you reintroduce the new pricing strategy in Italy as well, the point then you think will be slightly higher than that 48 but with no decline in the volumes. Is that fair?

Giorgio Modica: Yeah. We are expecting to have a higher blended yield with respect to the one that we were targeting as a sustainable one once the migration and the transition of fee schemes is going to be implemented.

Andrew Coombs: Okay. Thank you.

Operator: We currently have no question coming through. As a final reminder, if you would like to ask a question, please press star one now. There are no further questions, so I will hand you back to your host to conclude today's conference.

Giorgio Modica: Thanks very much to everyone who attended this call. It was important for us to give you the possibility to ask directly question to Simon. I believe it was an important point to meet and discuss in – during those volatile days.

So again, thanks everyone who prepared the presentation, the presenters, Aurélie, and all the one who attended, analysts and investors. Thanks. Have a nice rest of the day.

Simon Gallagher: Thank you.

Operator: Thank you for joining today's call. You might now disconnect. Host, please stay on the line and await further instructions. Thank you.

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