CIC

Value Range

8,915 – 9,372

LSEG (lighter line) FTSE 100 market vs price relative

Tuesday, 22 November 2022

Close Price (GBp)	8,164.00
Value Range Low	8,915.10
Value Range High	9,372.30
MCAP (m)	£41,144.31
EV (m)	£46,944.31
Index: Public	XLON
Financial YE	31-Dec
Reporting Currency	GBP
Listing Currency	GBP
Business Activity	
Financial Services	

Key Metrics

Gross debt (m)	£8,320.00
Cash (m)	£2,520.00
Net Debt (Cash) (m)	£5,800.00
Net Operating Cash (m)	£2,550.00
Revenue (m)	£7,460.00
Net Income (loss) (m)	£934.00
Key Ratios	
(Net Cash) / Shareholder Equity %	14.10%

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London Stock Exchange Group Plc

Core Investment Case

London Stock Exchange Group (LSE: LSEG) is a financial markets infrastructure company operating across the capital markets value chain – capital issuance, pre-trade, trade execution to post-trade. LSEG appears undervalued based upon its top line growth potential and potential OPEX savings. LSEG operates via three divisions – Data & Analytics (data insight and management), Capital Markets (primary issuance and secondary market trading), and Post Trade (clearing, risk management and compliance). The Group has a robust financial position with high quality recurring revenues and customer retention rates. LSEG is positioning itself as a global leader in real-time data-analytics solutions.

➢ Diversified assets across financial markets value chain;

➢ Completion of two recent acquisitions – GDC and MayStreet;

➢ Solid financial growth, 1H22A pro-forma income +6.2%;

➢ High cash generation - cash & CE at £2.5bn in 1H22A.

GBP (m)	MCAP	EV	RoA %	RoE %	NCO	Levered FCF
2022	41,144.31	46,944.31	0.13%	4.15%	2,550.00	1,290.00

Multiples	EV/ Revs	P/ S	Trail PE	BV/ Share	P/ B	Current
2022	6.85	6.14	48.20	46.45	1.74	1.00

Investment Case

The London Stock Exchange Group is a diversified global financial markets infrastructure company with three core divisions – Data & Analytics, Capital Markets and Post Trade. Its high recurring revenue model generates significant, relatively predictable cash flows.

High quality assets – LSEG's three business model pillars are leaders in their respective markets with strong competitive advantages. Data & Analytics solutions are used by the world's largest top 30 banks and top 10 assets managers. The Capital Markets division is the leading listing venue in Europe by number of IPOs, and a leading venue for global interbank FX trades. The Post Trade division is a leading global clearing house with >90% global share of cleared interest rate swap notional outstanding.

Highly cash generative business: 73% of 1H22A revenues (excl. recoveries) are recurring and primarily generated via subscription and license fees with contract duration between 12-24 months. The high recurring revenue underpins strong underlying cash generation – adj. EBITDA margin of 48.8% and cash & CE of £2.5bn in 1H22A.

Solid financial growth prospects: LSEG is implementing a multi-year strategy to accelerate growth and increase scalability. It is targeting an organic growth CAGR of 5%-7% (2020-23E) and estimates EBITDA margin of at least 50% by YE23E. This should be positive for EPS growth, which is likely to continue in double-digits (according to consensus estimates).

Continued focus on portfolio enhancement: LSEG continuously repositions its portfolio to expand its capabilities and drive incremental growth. This includes the acquisition of GDC (Apr 22) and expected acquisitions of Quantile and TORA, which will enhance its offerings in Post Trade, Trading & Banking and Customer & Third-Party Risk respectively. During 1Q22, LSEG also announced the divestment of BETA+ (back-office processing solutions) and aims to return a significant portion of the net proceeds to shareholders via a share buyback.

Catalysts

Positives: OEPX reductions; Demand for sophisticated data analytics solutions; Demand for sustainability in finance; New acquisitions.
Negatives: Slowdown of market M&A and IPO activity; Reduction in secondary market liquidity; Global market volatility; Inability to meet net-zero targets.

Operational Strategy

LSEG's strategy is focused on investments to accelerate growth and scale its operations, to make it a **global leader in real-time data analytics**. Management has set out four main strategic objectives: integrating businesses, driving growth, building an efficient and scalable platform and strategic acquisitions.

Integrating businesses: LSEG continues to integrate its businesses to add value for its customers. The integration of the Refinitiv acquisition is progressing and LSEG remains on track to achieve revenue and cost synergies - LSEG plans to improve EBITDA margins via cost control (opex reductions in our view).

3 Divisions - LSEG has three main financial market infrastructure divisions – **Data & Analytics**, **Capital Markets** and **Post Trade**:

Data & Analytics (66% of 1H22A revenues excl. recoveries – financial contribution from businesses contained within the Borsa Italiana divestment). Combining the businesses Refinitiv (global provider of financial markets data) and the FTSE Russell (leading global provider of benchmarks, analytics and data solutions) provides LSEG with the infrastructure to take a leadership position in capital markets data analytics. The FTSE Russell has more than $16trn benchmarked to LSEG indices.

Exhibit 1:   **LSEG Data & Analytics solutions**

Solution	Description
Asset management	Solutions to facilitate the investment process managing risk and compliance.
Financial news	Coverage led by Reuters, exclusive to Refinitiv, with 10,500+ other sources.
Investment banking	Workflow-centric solutions for M&A, debt and equity capital market.
Risk and compliance	Innovative suite of solutions for effective audit, risk and regulatory compliance management.
Trading	Real-time data, Reuters news, advanced analytics and reliable post-trade services.
Wealth management	Improving decision-making, optimising business performance and deepening customer engagement.
Refinitiv Eikon	An 'open'/flexible technology solution providing access to data and market-leading news.
Refinitiv Data Catalogue	Quality data across LSEG's full range of products and services.
Refinitiv Workspace	Open-architecture workflow solution with coverage of financial data, news and analytics.

Sources: ACF Equity Research Graphics; Company reports.

Capital Markets (20% of 1H22A revenues excl. recoveries)

LSEG offers customers access to capital markets and liquidity and across multiple assets, for example:

- International equity – non-UK stocks.
- Fixed income – Also known as debt securities/bond markets providing fixed/regular interest payments.
- Exchange-traded funds (ETFs)/exchange-traded product – a basket of stocks, bonds, other assets traded on an exchange.
- Foreign exchange markets - a market for the trading of currencies.

The capital markets group includes the London Stock Exchange, AiM, Turquoise, CurveGlobal, FXail and Tradeweb.

Post Trade (14% of 1H22A revenues excl. recoveries)

Through its London Clearing House (LCH), LSEG helps global financial institutions manage their capital and counterparty risk. Via the UnaVista platform, LSEG supports its customers clearing and reporting obligations providing risk, balance sheet and financial resource management solutions.

Clear growth targets: LSEG plans to deliver revenue CAGR of 5%-7% through to YE23E. The cost synergy targets set out from the Refinitiv acquisition along with cost control, should help drive margin expansion and allow LSEG to deliver double-digit EPS growth over the next few years.

Building a scalable platform: LSEG project investments aim to improve the customer experience and improve scalability, particularly in data and analytics. For example, the rollout of Workspace (next generation software workflow solution that facilitates human accessibility and financial data distribution) and migration to the cloud are programs to improve enterprise customer experience and reduce OPEX. Our expectation is that LSEG's technology and infrastructure investments should keep LSEG competitive and reduce OPEX, and we would therefore be alert to reduced revenue growth and or flat or rising OPEX.

Strategic acquisitions: Inorganic growth is also a key part of the company's overall growth strategy. In 1H22A LSEG completed the acquisitions of GDC (global provider of high-quality verification data for KYC-Know Your Customer- requirements) and MayStreet (leading market data solutions provider). In 2H22E LSEG expects to close the acquisitions of Quantile (to expand LSEG's range of post-trade risk management solutions) and TORA (to expand LSEG's digital assets and trading capabilities). The acquisitions are good examples of how strategy, planning and preparation meets opportunity, strengthening LSEG's offering.

Exhibit 2:   **LSEG significant acquisitions 2022**

Year	Acquiree	Deal value (GBP m)	Equity ownership acquired (%)
Apr-2022	Global Data Consortium (GDC)	Undisclosed	11%
May-2022	MayStreet	Undisclosed	
2H22E	Quantile	274	
2H22E	TORA	239	

Sources: ACF Equity Research Graphics; Company reports.

Sustainability strategy: The London Stock Exchange Group (LSEG) is proving itself a leader in sustainability. LSEG focuses on sustainable economic development – a balance between economic progress, social inclusion and environmental protection. LSEG has produced a Sustainability Report every year since 2019.

ESG innovations: LSEG is on track to launch 100+ new ESG index products by YE22E. In Oct 22, LSEG launched its **Voluntary Carbon Market,** which will facilitate financing of projects that mitigate climate change by reducing GHG emissions – providing capital at scale and disclosure transparency.

LSEG has a critical role in re-engineering the financial ecosystem by working towards decarbonization, innovating and growing the green economy, whilst ensuring individuals can benefit from sustainable economic growth.

LSEG's 'refreshed' sustainability strategy incorporates three strategic priorities. LSEG publishes metrics and disclosures around these three strategic priorities.

"Accelerate the 'just' transition to net zero"
- Transition capital – Increasing access to capital for companies and issuers to finance a low-carbon economy transition.
- Data and disclosure – Improving transparency for companies and investors through clear, comparable and comprehensive data, analytical tools and research.
- LSEG Net Zero – Reducing carbon emissions by 50% in 2030E and becoming net-zero by 2040E.

"Enable the growth of the green economy"
- Green finance – Supporting green capital growth for sustainability, clean growth and sustainable economic activity.
- Research – Leveraging research to support the green economy growth.
- Engagement – Scaling global green economic growth through market collaboration, innovation and public policy.

"Create inclusive economic opportunity"
- Inclusive culture – Promoting a culture that values and embraces diversity.
- Inclusive markets – Promoting inclusion within companies, industries and societies via market collaboration and increased disclosure.
- Economic empowerment – Enabling access to education, employment and enterprise opportunities to support socio-economic equality.

Management Team

➢ **CEO, David Schwimmer.**

David joined LSEG as its CEO in August 2018. Prior to this, he spent 20 years at Goldman Sachs in a number of senior executive positions. Before joining Goldman Sachs, David was an Associate at Davis Polk & Wardwell. David has a post-graduate degree in law from Harvard University (MA, US), a post-graduate degree in International Affairs from The Fletcher School at Tufts University (MA, US) and a BA from Yale University (CT, US).

➢ **CFO, Anna Manz.**

Anna joined LSEG in November 2020 as its Chief Financial Officer and brings significant consumer, financial and strategic experience to the Group. Prior, Anna was CFO and Executive Director at Johnson Matthey plc for over four years and she spent 17 years at Diageo plc in a number of senior finance roles, including Chief Strategy Officer. Anna has a BA & MA in Chemistry from the University of Oxford (UK).

➢ **CRO, Balbir Bakhshi.**

Balbir joined LSEG in January 2021 as its Chief Risk Officer, bringing a commercial understanding and knowledge of risk management. Previously, Balbir was the Group Head of Non-Financial Risk Management at Deutsch Bank and Managing Director/Group Head of Operational Risk Management at Credit Suisse. Balbir is also on the board of London Clearing House (LCH) and Tradeweb. Balbir has an M.Sc. in Finance from Brunel University (UK).

Risks

Capital risk –An increased regulatory capital requirement could force LSEG to raise new money in uncompetitive conditions. Failure to raise capital could result in an inability to execute LSEG's growth plans and cost efficiencies.

Acquisition risk – Inorganic growth remains a key part of LSEG's growth strategy. Overpaying for an acquisition is a common shareholder value-destroying risk. Furthermore, failure to successfully integrate acquisitions could adversely impact operations.

Clearing house risk – LSEG's clearing house activities expose it to a number of financial risks that arise from its obligation to guarantee contracts between counterparties in case a member defaults. In case of a member defaulting, LSEG's clearing house is exposed to market risk as well as liquidation risk.

Global macroeconomic risk – As a global provider of financial infrastructure, LSEG operates across a range of equity, fixed income, derivatives and currency products. A global recession could lead to reduced activity in the markets, which could adversely impact LSEG's revenue and profitability.

Technology risk - LSEG operations are highly dependent on the smooth functioning of its sophisticated technology infrastructure. Any technology failure could result in system outage, thereby impacting the orderly functioning of the capital markets.

Cybersecurity risk – LSEG's business activities rely extensively on technology and software. In addition, the activities involve the use and retention of confidential data and information. These activities make LSEG both attractive to and potentially susceptible to cyberattacks.

Value Range £8,915-£9,372

Trading Multiples Valuation

Exhibit 3:　**LSEG peer group metrics**

TTM Metrics / Company Name	Market	Tkr	EV $(m)	Revs $(m)	EBITDA $(m)	FCF $(m)	Staff	GM%	EBITDA M%	EBIT M%	FCF M%
London Stock Xchg	**XLON**	**LSEG**	**55,784**	**8,865**	**3,113**	**1,533**	**23,261**	**78.82%**	**35.12%**	**23.12%**	**17.29%**
Intercontinental Xchg	XNYS	ICE	76,433	7,360	4,600	2,020	8,935	97.15%	62.50%	51.49%	27.45%
Deutsche Boerse	XFRA	DB1	38,027	5,120	2,236	807	10,200	69.01%	43.66%	40.53%	15.77%
ASX	XASX	ASX	5,437	718	505	293	790	95.37%	70.27%	68.72%	40.78%
OTC Markets	OTCM	OTCM	677	95	41	30	82	95.26%	42.81%	41.31%	31.22%
Average							5,002	89.2%	54.8%	50.5%	28.8%
Median							3,691	95.3%	53.1%	46.4%	29.3%

Sources: ACF Research Estimates; Companies reports; Refinitiv.

Exhibit 4:　**LSEG peer group multiples**

TTM Metrics / Company Name	Market	Tkr	MCAP US$(m)	EV $(m)	EV / REVS	EV / EBITDA	EV / FCF	EV / NI	PER	P/ sales	P/ book
London Stock Xchg	**XLON**	**LSEG**	**48,892**	**55,784**	**6.29x**	**17.92x**	**36.39x**	**50.26x**	**50.70x**	**6.14x**	**1.74x**
Intercontinental Xchg	XNYS	ICE	59,223	76,433	10.38x	16.62x	37.84x	29.97x	23.48x	6.11x	2.60x
Deutsche Boerse	XFRA	DB1	33,540	38,027	7.43x	17.01x	47.11x	25.99x	22.29x	6.29x	3.75x
ASX	XASX	ASX	9,201	5,437	7.57x	10.78x	18.57x	16.08x	27.14x	13.53x	3.70x
OTC Markets	OTCM	OTCM	705	677	7.11x	16.61x	22.77x	21.92x	21.82x	7.05x	20.52x
Average					8.12x	15.25x	31.57x	23.49x	23.68x	8.25x	7.64x
Median					7.50x	16.61x	30.30x	23.96x	22.88x	6.67x	3.73x

Sources: ACF Research Estimates; Companies reports; Refinitiv.

LSEG excluded from multiples means and medians.

We exclude the subject company of this investment research note from the average and median values in order to make comparison with the rest of the peer group as undistorted as possible. We also rely more on the median values as the median is a statistically better indication of central tendency than the average.

On our selected trading multiples measures, LSEG overall appears to be trading at a premium to the median multiples for its peers – which can suggest either i) LSEG is overvalued or ii) LSEG warrants a premium based on delivered growth and or current higher margins. In this note we present a different argument to either i) or ii).

LSEG margins are at the low end of our peer group, but we assess that LSEG's strategy combined with its high head count provides room for significant margin improvement compared with the same potential at its peers.

Note that competing US exchange owner ICE 's 3yr-CAGR revs is 13% vs. Australia's ASX at 0.13%. ICE EV/REVS ~10x is favourable cf. with ASX's ~9x. We expect ASX's monopoly EBITDA and FCF margins to erode (see ASX CIC here). In a global economic correction scenario, we assess that ICE at current ratings is less vulnerable vs. peers and may be able to position itself for further rapid growth in an upturn.

Margin potential - LSEG unlevered FCF margins are 2 percentage points above Deutsche Boerse and at least 10 percentage points below its other peers. LSEG books the highest revenues within our peer group but it also has by far the highest staff levels.

On a revenue per head basis LSEG currently performs less well than its peers, e.g. rev/head £380m versus the median of £824m, EBITDA per head is £133m versus £497m (median). LSEG's strategy of acquisitions and business integration could suggest that headcount will increase, however LSEG's focus on cloud integration and commitment to keeping costs under control suggests to us that measures are in place to scale the company's recurring revenues business model and to make substantial reductions in headcount and so OPEX.

Germany's competing exchange owner, DB1 is targeting revenue, EBITDA and EPS CAGRs of 10% to 2023E. Since 2019, DB1 has achieved an average 11% net revenue and 12% EBITDA growth p.a.. The performance driver is organic secular growth markets and asset classes, which we expect to contribute 5pp (50%) to overall net revenue growth to 2023, with the rest coming from M&A activities.

Relative valuation – LSEG's revenue 3yr CAGR is 34% vs. ICE at 13% and DB1 at 12%. LSEG has indicated that it has a strong organic growth path and it has shown that it is willing and able to make regular acquisitions to drive additional inorganic growth.

We infer overall that LSEG has stronger revenue growth prospects and strong OPEX cutting potential, which in turn should lead to improved FCF margins and a higher NPV. Our value range based on relative trading multiples is currently ~10-15% above the close prices in this note.

Current market conditions of lowered IPO activity and lower market liquidity will hold back the development of our LSEG value range. Our key catalyst is a significant improvement in head count to revenue or unambiguous guidance on how such a margin improvement will be delivered.

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