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LSE.L - Q1 2016 London Stock Exchange Group PLC Interim Management Statement Call

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## CORPORATE PARTICIPANTS

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**David Warren** *London Stock Exchange plc - CFO*

## CONFERENCE CALL PARTICIPANTS

**Daniel Garrod** *Barclays - Analyst*

**Arnaud Giblat** *Exane BNP Paribas - Analyst*

**Peter Lenardos** *RBC Capital Markets - Analyst*

**Martin Price** *Credit Suisse - Analyst*

**Kyle Voigt** *Keefe, Bruyette & Woods - Analyst*

**Owen Jones** *Citi - Analyst*

**Mike Werner** *UBS - Analyst*

## PRESENTATION

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**Operator**

Ladies and gentlemen, thank you for standing by and welcome to the London Stock Exchange Group Q1 results. (Operator Instructions). I must advise you the call is being recorded today, Wednesday, April 27, 2016.

I would now like to hand the conference over to your speaker today, Paul Froud. Please go ahead.

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**Paul Froud** - ***London Stock Exchange plc - Head of IR***

Thank you. Good morning, everyone. Thank you for joining the call this morning. With us today is David Warren, CFO; Tom; and myself. It's going to be the usual format for the call. So, first of all, we'll just briefly summarize the key performance from the results today. And then we turn it over to you on the line for questions.

So let me hand you over to David. Thank you.

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**David Warren** - ***London Stock Exchange plc - CFO***

Thank you, Paul. And good morning, everyone. We have made a strong start to the year. As you've seen from the statement, Q1 income from continuing operations increased 9% year on year to GBP388 million.

On an underlying basis, income increased by 7%, with all main business divisions delivering growth on an organic and constant-currency basis.

So let me pick out a few highlights from the quarter. Capital markets revenue increased 8%, and 6% at constant currency, with growth in primary markets as annual fee income offset an expected reduction in new issue activity.

Secondary market activity was also resilient despite the testing market conditions, with increased trading in Italian equities and derivatives and good growth at Turquoise.

Moving to post-trade services in Italy. Headline income increased 12%, and up 8% at constant currency. A greater clearing volumes from Italian equity and derivatives helped drive CC&G revenues 6% higher. And NTI increased as initial margin held grew year on year.

Settlement and custody revenues declined 4%, driven partly by a reduction in assets under custody, which reduced by a similar amount.

Turning next to LCH. Income on a headline basis increased 15% (sic - see press release, "14% "), and 12% at constant currency. OTC clearing was again strong, an aggregate 22% revenue growth, with the main uplift at SwapClear, as well as growth at CDS and ForexClear. And in terms of NTI, it was a 27% like-for-like increase, again reflecting an increase in average cash collateral.

Turning now to information services where reported revenues increased 10%, and were up 7% in constant currency. This comprised 13% growth at FTSE Russell, 7% growth in real-time data revenues and a small rise in other products.

And finally, in technology services, here, revenues declined 17% on Q1 last year. This mainly reflects the timing of customer deliveries, which you have heard me say before can be lumpy.

Just before I finish, a few final points to make. The sale of the IM business, the Russell IM business, is on track and we expect completion by the end of this quarter.

As usual, we have commented on our financial position in general terms. Leverage has not materially increased since year-end, with cash flow offset by schedule debt interest payments and continued investment in the business.

Regarding our proposed merger with Deutsche Boerse, you'll see from today's announcement that there is no further update. We are working on shareholder documentation and will provide more information in due course.

And finally, in terms of outlook. As I said, we've made a very strong start to the year, with good performances across our major business lines. We remain focused on achieving the synergies from the FTSE Russell index operations and on investment in a wide range of growth initiatives.

In summary, we believe that we are well placed to develop further. So again, thank you for your time. And now Paul and I would be happy to take your questions.

## QUESTION AND ANSWER

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**Operator**

(Operator Instructions). Daniel Garrod, Barclays.

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**Daniel Garrod** - ***Barclays - Analyst***

A couple of questions from me. First regards FTSE Russell. GBP96 million of revenues in the quarter is quite a step up from the quarterly run rate you had last year. It looked to me like ETF benchmarks, I know you've always said that's an imperfect measure, but was actually down quarter on quarter. So can you provide any more color around what's driven that? Is it expansion into the fixed income indices? More smart beta product; are there any particular areas you can highlight that's driving that good revenue performance there?

Second, I had a question around LCH Spider that you mention, that portfolio margining services. Can you say anything more around the benefit that that's going to bring to customers potentially in capital efficiency gains? What sort of products they can offset that they couldn't previously with that product and can it be linked easily with ETDs?

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**David Warren** - ***London Stock Exchange plc - CFO***

Right, okay. I think on FTSE Russell, certainly there I -- the market conditions are certainly affecting AuM and AuM-related fees. And you're right, it's not always a perfect correlation, but I think within that business generally, there are a lot of new things going on.

There are new products that are being developed. There had been some fee adjustments and there's also some work that continues in achieving the revenue synergies that we announced as part of the transaction.

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**Paul Froud** - ***London Stock Exchange plc - Head of IR***

Yes. And the derivatives business was very, very good in that quarter as well, so we've got the benefit of that, Dan.

**David Warren** - ***London Stock Exchange plc - CFO***

Yes.

**Daniel Garrod** - ***Barclays - Analyst***

Okay, yes.

**David Warren** - ***London Stock Exchange plc - CFO***

I think on the portfolio margining service at LCH, this is something that was announced long ago. And as you know, CurveGlobal and NLX have said that they are joining that. It is going through regulatory reviews and we expect that it will be operational once those reviews are complete.

I think on the basic concept of portfolio margining, we've been clear on those. But it's basically the opportunity under regulation to look for opportunities where listed derivatives and OTC products can offset one another for portfolio margining benefits that are on top of the compression benefits that SwapClear is already delivering.

**Daniel Garrod** - ***Barclays - Analyst***

Thank you.

**Operator**

Arnaud Giblat, Exane.

**Arnaud Giblat** - ***Exane BNP Paribas - Analyst***

Just if I could follow up on the portfolio margining question. Do you have any quantification perhaps of the capital savings that can be achieved as a standalone business?

And perhaps, there have been a few numbers in the press suggesting up to $7 billion of capital savings to be achieved through portfolio margining if a merger of Deutsche Boerse and LSE happens. Is that number, does that sound right to you, even as a ballpark figure?

Could these capital savings achieved, be achieved even without the merger because, again, in the press, there's clearly a lot of talk about not merging the clearing houses?

And secondly, I wanted to come back to the cost synergies from the Deutsche Boerse/LSE merger, if that's all right. Looking at the operating margin at LCH, it's a lot lower than all the other businesses of the Group. So should we be assuming that a larger proportion of revenues, say, does a larger proportion of the cost synergies come from LCH pro forma, the revenue base?

**David Warren** - ***London Stock Exchange plc - CFO***

Right, so you've asked a number of questions there. I think with respect to the portfolio margining and the number that you referenced, that is something that has been announced. Part of it has been discussed as part of the transaction and as I said, I'm really not going to give any more updates on the transaction today.

LSEG PLC post call clarification: LSEG believes that a Portfolio Margining Service would provide significant customer benefits through margin relief and cost of capital savings. These potential benefits have not been quantified at this stage.

With respect to the Spider product, as it will be introduced at LCH, there are certainly benefits. I think the exact benefits will depend on how the customers use it and what opportunities they have.

So we would not put any more statements out in terms of the benefits of that, and certainly, won't comment any more today, as I said, on information that we've put out on the merger.

I think the second question was on cost synergies and specifically related to the LCH margin. I will just talk about LCH now as a standalone Company that is majority owned by the Group.

As you know, since the acquisition of that, we have been going through a process of making LCH more efficient by streamlining the technology and by doing and taking out costs. As you know, we've taken out EUR60 million and announced another EUR40 million, and we've said that there's further work that continues.

That work is important for LCH. That work is continuing now and that work will make LCH more efficient. It will definitely streamline certain operations and that will definitely have the impact of increasing margins.

If you asked me that question in the context of the transaction, again, it's not something that I would comment on. All we've said about cost synergies is that there are opportunities across the entire combined Group. And those opportunities are the opportunities that were evaluated and have contributed to the analysis that produces the number that we've announced as synergies.

But, again, to say more about the transaction today and in the merger today is not something we're going to go into.

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**Arnaud Giblat** - ***Exane BNP Paribas - Analyst***

Okay. Just a quick one then on the results themselves. NI is up, I think 38% or something like that; and basically, cash balances and initial margin held is up between 10% and 11% on a sequential basis.

I'm wondering there that that implies that net interest margin is up quite a bit when bond yields have been coming in. So could you maybe give us a bit of an indication whether you've been going up the duration, taking some more duration risk or credit risk, or what's driven the increase in net interest margin? Thanks.

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**David Warren** - ***London Stock Exchange plc - CFO***

The increase has primarily been driven, as we said, by the increase in cash collateral. What actually goes into that total income line is a mix of a number of things in terms of the investments that are chosen, the yields. So, I think beyond that, the major part, the major factor that's driving that variance has been the increase in cash collateral.

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**Arnaud Giblat** - ***Exane BNP Paribas - Analyst***

Thank you.

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**Operator**

Peter Lenardos, RBC.

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**Peter Lenardos** - ***RBC Capital Markets - Analyst***

I just had three questions. First, David, could you please give us an update on the repricing efforts at Russell indices?

The second question would be your thoughts and comments on the potential suspension of the FTT in Italy?

And the third one is just a clarification point to confirm that no bid for the LCH minorities needs to be made in the event of a merger or takeover of the LSE Group? Thank you.

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**David Warren** *- London Stock Exchange plc - CFO*

Yes. I think on FTSE Russell generally, we are, as I've said, making good progress on the synergies on that acquisition that we announced at the time of the transaction. And those were both revenue synergies, as well as cost synergies. And so their activity, and we're very much on track in terms of the cost synergies and making very good progress on the revenue synergies.

So there has been some repricing within the services within FTSE Russell, as we said there would be, and that's definitely contributing to this. But that was definitely one of the important benefits of the transaction, because we saw opportunities for significant revenue synergies, in terms of cross-selling and in terms of the harmonization of the commercial policies between the two companies. And we are definitely continuing to work on that and you're seeing some of that benefit in the results today.

I think on the second question, with respect to the article yesterday on the FTT, we certainly note it. But we also, I think, would tell you at this point in time that that could be definitely a positive development. It definitely will take some time. It's one we'll continue to watch. But if this does go forward, it will require a change in the primary legislation. So I think you just need to understand in that context.

And then I think the final question, you'll have to remind me again. This was about --

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**Peter Lenardos** *- RBC Capital Markets - Analyst*

It's about potential bid. Does a takeover or merger of the LSE Group require a bid for the LCH minorities?

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**David Warren** *- London Stock Exchange plc - CFO*

No, it does not.

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**Peter Lenardos** *- RBC Capital Markets - Analyst*

Okay. Thank you very much. Thanks, David.

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**Operator**

Martin Price, Credit Suisse.

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**Martin Price** *- Credit Suisse - Analyst*

Just a quick question on the standalone LSE cost base. Clearly, you've delivered good revenue growth in Q1, but I guess, as you've highlighted, you've also been investing quite a bit in growth. So I just wonder if you could help us think about how we should expect the standalone Group cost base to develop this year. Thank you.

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**David Warren** *- London Stock Exchange plc - CFO*

Yes, I might ask Paul to comment on -- because he'll have more of a flavor of what he's already been discussing with people. But obviously, we don't give costs at this point in time, but generally, I think as we've said, we will be seeing cost, in terms of cost of sales, which we're not putting out today, but definitely will be part of our interims when we report three months from now.

So those will tick up because revenue has grown in the areas where cost of sales matters, which is in SwapClear primarily and in puts in Russell.

In terms of investments for growth, we definitely will continue to invest in growth. Our asset mix is stronger and it's important that we continue to invest in those areas. So we definitely will be increasing spending there over what we've done in the past. But I think it's all well controlled and in the mix.

And I think the last thing I would say before having Paul put some more specifics on it if he wants to, is that I think we also, and this I think is important, continue to maintain the discipline around keeping our core costs controlled. So I think you have to look at the balance of all three of those when you think about our cost progression for the year.

Paul, would you like to --?

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**Paul Froud** *- London Stock Exchange plc - Head of IR*

Yes, thanks, David. As you can see, this is an update on revenues and income only, so we've got no specific update on the costs, so we can't give you any more quantification.

However, as David said, we'd just refer you back to the tight cost control for the full year last year; the organic underlying cost base increased only 1%. But we have talked about the continuing investment.

And then to echo David's point, clearly, the cost of sale would tick up as you would expect, because of the growth we've seen in various lines; David's mentioned the index, the OT clearing business. And of course, Turquoise which has performed very strongly and of course, there's the element of the rebates on that service as well. So I think pretty much in line with what you'd expect.

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**Martin Price** *- Credit Suisse - Analyst*

That's great. Thank you very much.

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**Operator**

(Operator Instructions). Kyle Voigt, KBW.

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**Kyle Voigt** *- Keefe, Bruyette & Woods - Analyst*

So first question just on the primary markets revenues. So you still managed to grow these 3% year on year on a constant-currency basis. I'm just wondering what drove the growth here. I guess we were expecting this line to face more headwind during the quarter because of the very weak IPO market.

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**David Warren** *- London Stock Exchange plc - CFO*

Yes, so I think, as I said in my comments, you've got -- there's definitely the new issue activity which I think, as you can see from the results, has come down a bit from the prior year, just given the market conditions we're under. But in terms of the growth in that area, as we said, that's come from basically the annual fee income for the companies that are listed.

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**Kyle Voigt** *- Keefe, Bruyette & Woods - Analyst*

But were there pricing adjustments at the beginning of the year or --

**Paul Froud** *- London Stock Exchange plc - Head of IR*

Yes, so we have annual increases to the fees for the annual fee element of that. So we're seeing some benefit from that. But to David's point, on the new issuance, although it's down, of course, the market still remains open. We are still seeing customers -- companies coming through. There's both new issue activity, there's also secondary issues as well. So the market doesn't shut.

I think in terms of the pipeline going forward, to your question about how do you see the prospects ahead, there is still a lot of interest in companies coming through to market. So I think there is still the prospect that we'll see continued issuance, it's just hard to predict exactly as to how much that comes through in the next quarter.

**Kyle Voigt** *- Keefe, Bruyette & Woods - Analyst*

And then just a follow up is during the joint call with Deutsche Boerse, Carsten said that the LSE shareholder vote would occur before the private Brexit vote. Could you confirm whether this is still the case?

**David Warren** *- London Stock Exchange plc - CFO*

No, we're not going to confirm anything further on the transaction today. As I said, there will be no update. We're continuing to prepare the shareholder documentation. And when that's ready, we'll have more updates in due course on the documentation, as well as further information about the transaction.

**Kyle Voigt** *- Keefe, Bruyette & Woods - Analyst*

Okay, worth a shot, thanks.

**Operator**

(Operator Instructions). Owen Jones, Citigroup.

**Owen Jones** *- Citi - Analyst*

Two questions from me. Firstly, on your technology services division, you mentioned there is a lumpy revenue stream. Do you have a view yet as to whether or not we can expect the catch-up of these revenues in Q2? Or will these be pushed back into a second-half catch-up?

And then secondly, with regards to the CDS volume increase that you saw in the first quarter and the increase in activity at SwapClear, can you just remind us of the revenue dynamics and what the difference was or what the delta was between the CDS volume increase versus the revenue change?

**David Warren** *- London Stock Exchange plc - CFO*

With regard to the technology, I think the point I made in my prepared remarks is really just around the nature that business. It is around software development. And based on the accounting rules, that software needs to be developed and tested and accepted by the customer before we can start to, under the accounting rules, book the revenues.

So, just by definition, depending on the customer order, depending on the various development cycles and delivery cycles, that revenue will vary from quarter to quarter.

I won't say exactly when, in terms of how it is the next quarter or quarters beyond or for the year. We're not making those statements today. But in general, I think you need to look at technology revenues, just because of the nature of the business and how we need to account for those revenues over a longer period of time.

But the business still is an important business for us. It's a small part of our revenues to be sure. But it is an important part of contributing to the technology that enables a lot of our systems. And it's technology that we also have been successful in selling to third parties.

I'm going to ask Paul to answer the second question on the fees.

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**Paul Froud** - ***London Stock Exchange plc - Head of IR***

Yes. So on CDS, look, as we said and you can see from the results, we saw an aggregate increase across all of the OTC clearing services. The main part of that was SwapClear. As we said, that's where you'd expect to see the biggest growth. But nonetheless, as we've commented before, we've seen some increase in CDS volumes.

The pricing schedule is the same across all of the OTC services. In other words, it's primarily membership fee based. So you won't necessarily see a linear change in the revenues in line with the volumes. But I think that's understood. And that's the same for CDS.

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**Owen Jones** - ***Citi - Analyst***

Okay, thank you very much.

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**Operator**

Mike Werner, UBS.

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**Mike Werner** - ***UBS - Analyst***

Two quick questions, first on Turquoise. We saw a significant increase in volumes in the first quarter. Can you just talk a little bit about that? Is there anything specific there? What countries has that been coming from within Europe?

And on the second question, with regards to SwapClear. Can you let us know what portion of the business reported here is coming from the US with regards to the centrally-cleared swaps?

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**David Warren** - ***London Stock Exchange plc - CFO***

Yes, on Turquoise, look I think that this business, this service I think continues to grow. We're quite pleased with it. I think, as you know, it's a Pan-European platform. And I think without telling you, without discussing where the growth is coming from one country versus another, I think it's just coming pretty much from all over.

And we definitely are focusing on it and looking to expand our reach into other European countries, where the platform has not really been used.

So I think it's just part of an overall program of trying to improve the adoption and the use of Turquoise. So we're quite pleased with the results there.

I think on SwapClear, we don't break it down. But a large part of that does come from the clearing activity in US dollar interest rate swaps.

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**Mike Werner** - ***UBS - Analyst***

Thanks, guys.

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**Operator**

(Operator Instructions).

**Paul Froud** - ***London Stock Exchange plc - Head of IR***

Okay, I think that looks like we've run out of questions then, unless there are any more. No, it doesn't look like there are any more.

**Operator**

No, there are no further questions.

**Paul Froud** - ***London Stock Exchange plc - Head of IR***

Okay. Well look, thanks, everyone, for joining the call. As we said, we think we've made a strong start to the first quarter, some good results. If you've got any more questions after this call, please do give us a call as normal. Thanks very much for joining us.

**Operator**

Thank you very much. That does conclude the conference for today. Thank you for participating. You may all disconnect.