

Offer a tribute: LSE group sells Borsa Italiana to Euronext to win Antitrust favour over Refinitiv deal

London Stock Exchange Group (LON:LSE) – market cap as of 30th October 2020: £29.13bn

Euronext (EPA:ENX) – market cap as of 30th October 2020: €6.23bn

Introduction

After long talks, The London Stock Exchange announced on Friday the 9 of October 2020 it will sell Borsa Italiana to Euronext in a €4.3bn only-cash deal, a price that values the target at 16.7x times its 2019 EBITDA earnings before synergies.

The transaction brings great advantages to both parties. While Euronext will achieve its goal to expand its European operations, improving its equity operations and breaking into fixed income trading, LSE will certainly manage to alleviate the European Commission's concerns about its excessive control over the European bond market following its bid to acquire the data provider Refinitiv. However, these benefits come at a high cost for Euronext, which is expected to pay a price corresponding to more than 50% of its €7bn aggregate market value and which, as a result, will recur to a total of €4.2bn in equity and bond issuances.

About Euronext NV

With headquarters in Amsterdam and Paris, Euronext NV is the leading stock exchange in Europe and sixth in the world with control over exchanges with 1,463 listed companies, corresponding to an aggregate market value of around €4.4tn. The company is listed on the Paris Exchange (EPA), which is a subdivision of Euronext itself, and its common shares trade under the ticker symbol ENX. Its product portfolio includes equity, bonds and exchange traded funds as well as warrants, certificates, derivatives and indices.

Founded in 2000 when the stock exchanges of Amsterdam, Paris and Brussel decided to merge, it has undertaken many M&A operations throughout its history up to when, in 2006, it merged with the New York Stock Exchange and in 2014 went public as a spin-off of the latter.

In FY2019, Euronext positively impressed investors with double digits growth figures. Annual EPS increased by 10.9% up to €3.9 resulting in a 45% increase in the price of ENX stock if we consider the period from the beginning of October 2019 to that of October 2020. However, such a raise was for the most part erased by this month's 17% stock price decrease with the stock price going down to €88 today from €105 on the second of October. This drop is mainly due to the rumors and the announcement of the deal with LSE.

About Borsa Italiana

Headquartered in Milan, Borsa Italiana Group operates in the European financial markets and infrastructure business. It owns 99,99% of Borsa Italiana, the company that runs the Italian stock exchange, a 62.53% majority

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stake of the bond trading marketplace MTS S.p.A as well as Cassa di Compensazione e Garanzia S.p.A., the Italian clearing house, and Monte Titoli S.p.A., an Italian-based custody and settlement business.

Funded in 1998, in 2007 Borsa Italiana was bought for just €1.6bn by LSEG and has been controlled by the latter up to October 2020 when it was purchased by Euronext at almost four times the price it was sold for just 13 years ago. Indeed, it is its leadership in the market of ETFs, fixed income, warrants and certificates trading, together with its great recent financial performance, that most likely convinced the acquirer's board to close this extremely costly deal. Not only has Borsa Italiana Group surprised investors with an adjusted EBITDA of €280m and a €200m profit before tax in 2019, but it also owns the main fixed income electronic trading platform in Europe, one unique in its kind with over 500 unique counterparties and average daily volumes exceeding €100bn.

About London Stock Exchange Group

Founded in 1801, its more than two hundred years of history make the London stock exchange one of the oldest in the world. Thanks to such long-dated roots, LSEG became one of the leading European stock exchanges with over 5,000 employees and more than 2600 listed companies. In the last 2 decades, the company expanded forming the LSE group; in 2007 it merged with Borsa Italiana and in 2009 acquired MillenniumIT, a technology provider for global capital markets. In the future, the group is expected to expand further with the acquisition of Refinitiv, a deal still on hold due to monopoly concerns of the European Commission.

In the last two years, LSEG showed stable growth figures with average yearly earnings increase of around 8.5% with earnings up to £2,314bn in FY2019, a quite profitable year which saw EBITDA margin going up to the 55% threshold. At LSEG, stability goes together with profitability as testified by its 11% interest expense to net income ratio.

Industry Analysis

Exchanges deliver a fundamental service to the financial industry. They create a secondary market for assets, and thus liquidity for investors. Exchanges are present in most developed countries, and they are seen as a central piece of their respective economies. Therefore, they are often subject to stringent regulations to ensure fairness and stability. Due to economies of scale and regulation, usually, there is only one dominant exchange in each jurisdiction. The main asset traded in such exchanges is equity. Fixed income securities are usually sold over the counter by specialized dealers because the variation of securities is too high. Nevertheless, there are few exchanges that trade highly liquid bonds such as those of governments. For example, MTS, the trading platform involved in the Borsa Italiana deal, provides the dealer network infrastructure specialized in European government bonds.

The US is one of the few countries that hosts more than one exchange. It is home to the two biggest stock markets by capitalization of their listings: the New York Stock Exchange (~\$23tn) and the NASDAQ (~\$11tn). These two stock exchanges are followed by the Japan Exchange Group (~\$5.7tn), the London Stock Exchange Group (\$4.6tn), and the Shanghai Stock Exchange (~\$4tn) in the total valuation of securities listed. After the completion of the transaction, Euronext will take over LSEG's spot as 4th largest exchange (~\$5.1tn).

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There are two main types of exchanges, Organized Security Exchanges and Over the Counter Exchanges (OTC) exchanges. The former one provides liquidity by employing a specialist for each stock that matches buyers and sellers and also trades with the market participants to ensure an ordered market. Today most orders coming into an ordered exchange are executed electronically by computers. The most famous ordered exchange is the NYSE. On the other hand, an OTC exchange provides the infrastructure to connect market makers who stand ready to buy or sell each security. These dealers make a profit through the bid-ask spread. The most known OTC network is the Nasdaq. The advent of electronic trading blurred the line between OTC markets and Organized Exchanges. Generally organized exchanges provide a more secure liquidity because the specialist cannot exit the market, while dealers may retrieve themselves from trading. To avoid chaos during market turmoil some OTC exchanges have designated market makers for some securities.

Both types of exchanges are for profit organizations, and they generate revenues in similar ways. Usually, their business model consists of a combination of the following three monetization models:

- **Capital Markets:** Traditional exchanges collect listing fees from companies on their exchange. They also collect transaction fees from trades executed on the platform. Usually, companies pay an initial listing fee during their initial public offering followed by yearly payments based on their market capitalization. Trading generates revenues because market participants pay a small percentage of their trading value as a fee. LSEG charges between 0.25bps and 0.45bps on each equity trade. Usually trading revenues makes up for about $\frac{2}{3}$ of capital markets revenues while listing fees make up for the rest.
- **Information Services:** Being the platform for where buyers and sellers of assets can find each other, exchanges own pricing and transaction data. Investors usually pay a subscription or licensing fee to have access to timely data. Also, some exchanges started to offer their analytics services and create their own indices.
- **Post Trade:** These services support the primary trading functions. Exchanges offer regulatory reporting, clearing, settlement, and risk management services.

Exchanges generally have mainly fixed costs and low variable costs. Thanks to computerization, the cost of having five or 500 assets listed does not differ much. Thanks to these economies of scale, exchanges are prone to consolidation. Nevertheless, because of their importance within the economy, there is a lot of scrutiny over each deal by regulators. For example, the merger of LSE and Borsa Italiana in 2007 was heavily criticized, and LSEG failed to acquire the Deutsche Börse because of antitrust issues in 2017. Nevertheless, there has been a change of mind in recent years. The European Union is more favorable towards the consolidation of local exchanges to deepen capital markets and to reduce the reliance on London. At the moment European exchanges are facing regulatory risk because of the uncertainty around Brexit.

Deal structure

The deal is considered a divestiture forced by the regulator and the negotiations were conducted in a friendly way. Euronext will complete the acquisition with an all cash transaction of €4.325 billion as well as the additional cash generated until the completion of the transaction which is expected to be completed halfway through 2021. The deal values Borsa Italiana on the upper end of the range at 16.7x2019 EBITDA. London Stock Exchange Group (LSEG) will use the funds to reduce its debt to a targeted level of 1.0x–2.0x EBITDA.

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Euronext will use 300 million of existing cash and issue new debt (€1.8bn) and equity (€2.4bn) in order to finance the deal. The equity offering contains a €700 million investment by Intesa San Paolo and the Italian state investment fund, Cassa Depositi e Prestiti (CDP). The Italian Government regards the Borsa Italiana as a strategic asset, and CDP will end up with a 7.3% stake in Borsa Italiana through a rights issue.

Deal Rationale

To understand the main reason behind Borsa's sale it is worth going back to November 2019. Back then, LSE's shareholders approved the group's intention to buy Refinitiv, a financial data provider, for \$27 billion. However, due to stringent European regulations, which prevent firms from wielding too much market power, the completion of the deal depends on European Commission's approval.

Through Refinitiv's acquisition, LSE would have a majority stake in MTS (bond trading platform, owned by Borsa), as well as in Tradeweb, another trading platform. The Commission believes that left unchecked, LSE would exercise too much power over the market. Back in 2017, the same fears prevented the London-based group's merger with Deutsche Borse. LSE had been asked to divest MTS and LCH, its clearing house, in exchange for the deal's approval. The deal was never concluded.

Expecting similar requirements this time, LSE pre-empted the Commission and indicated its willingness to sell the Italian Borse, along with MTS. Most likely, the move will suffice to win the body's approval for the Refinitiv deal. By owning the data provider, LSE will hope to become a powerhouse in lucrative data distribution services.

The deal also represents a strategic opportunity for Euronext, the group behind, among others, Paris, Amsterdam, or Dublin stock exchanges. Through the acquisition of Borsa Italiana, the company will operate 25% of equity trading in Europe, which amounts to around \$36bn per day. Overall, Euronext will become the leading owner of market infrastructure in Europe and the continent's primary venue for equity financing with around \$50bn raised in 2019. The high strategic hopes help to explain the deal's valuation amounting to almost 17 times Borsa's 2019 EBITDA.

Furthermore, Euronext expects significant synergies as a result of the acquisition. The reduction of Borsa's cost base by around 20% is calculated to save more than \$53 mln per year.

The deal also had a political motive in it, with the Italian government being explicitly interested in regaining the country's stock exchange in the light of incoming Brexit. The government, which recently became more wary of foreign investment in strategic industries, will exert greater control over MTS, which operates Italy's \$2.5 tn sovereign bonds. By teaming up the state owned Cassa Depositi e Prestiti Equity with Euronext, it ensured that an Italian will become Borsa's chairman and regulatory oversight remains in the country.

Overall, the sale of Borsa Italiana to Euronext fits into the trend of increased consolidation in the wake of COVID induced recession, especially harmful to the European markets. Albeit primarily dictated by regulatory reasons, it will strengthen both London Stock Exchange's and Euronext's operations. With the former becoming not only a financial, but also data provider powerhouse, and the latter gaining a foothold in a weakened but crucial European economy.

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Market Reaction

On the 9th of October, the day the deal had been announced, shares in LSE rose 0.2% in early trading. The group's shareholders are expected to be pleased with Borsa's sale since the deal will likely pave the way to the completion of Refinitiv's acquisition. Shares closed 0.4% up on the same day.

Euronext's share price rose 0.6 per cent in early trading on the news of the deal. Shareholders were also pleased with the possibilities opened up by the deal, unanimously backing the acquisition. However, Euronext's stock was down 4.4% by the end of the session, possibly suggesting investor dissatisfaction with the high premium paid to acquire Borsa.

However, high market volatility caused by rising COVID-19 cases across Europe, and returning stricter lockdown measures, contributed to general decreases on the European markets. As a result, on 28th October shares in both LSE and Euronext closed down by 6.2 and 9.9% respectively.

Advisors:

Barclays, Goldman Sachs, Morgan Stanley, RBC, and Robey Warshaw acted as the financial advisors of the London Stock Exchange Group (LSEG). Mediobanca and JP Morgan helped Euronext, while Lazard assisted the state controlled Cassa Depositi e Prestiti Equity (CDP).

TAGS: LSE, London Stock Exchange, Euronext, Borsa Italiana, Italian Stock Exchange, Covid, Refinitiv, MTS, Government bonds, Stocks, Antitrust, Europe, Stock Exchange, OTC, Barclays, Goldman Sachs, Morgan Stanley, RBC, JP Morgan, Mediobanca, lazard, Cassa Depositi e Prestiti,

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