Notes from Management Meeting

Summary

We hosted a meeting today with LSE’s CEO David Schwimmer, CFO David Warren and Head of IR Paul Froud. See below for some takeaways.

- **M&A Commentary.** Management did not comment at all regarding the HKEX bid. However, speaking more broadly to exchange M&A, CEO David Schwimmer reiterated his prior stance that while he believes there will be more consolidation in the exchange industry, large scale cross-border pure exchange M&A is generally challenging, especially under the current political backdrop. Additionally, in general terms, we got the sense that LSE’s Board would take all factors into consideration when evaluating any potential transaction - and that would include both long-term value creation for LSE shareholders as well as the risks associated with pursuing any specific transaction (unsurprisingly). Our initial view when the HKEX news broke this morning was that LSE shareholders and Board would likely continue to support the Refinitiv transaction over HKEX offer and our view remains unchanged.

- **Expected Timeline for Refinitiv Transaction Including Anti-Trust Considerations.** A circular for the Refinitiv transaction is likely to be published in early November, with a shareholder vote expected to take place later that month. With respect to anti-trust review, that process has already begun, although no feedback has been received by LSE at this point given how early it is in this process. The longest timeline for competition reviews are expected to come from the U.S. and E.U. (potentially UK dependent upon Brexit outcome). When we asked about whether the outcome of the ICE-Trayport deal was concerning or could have implications for the LSE-Refinitiv deal, management noted that it viewed this transaction differently, as: (a) ICE closed Trayport prior to receiving regulatory approval, which it is not trying to do, and (b) LSE operates an open access model as it relates to trading and clearing (vs. a vertical silo model). Recall, LSE expects deal closure in 2H20.

- **Management Very Confident in Promised Cost Synergies.** We got the sense that management was very confident in achieving the £350 mln in deal related cost synergies (in addition to the $650 mln of efficiencies outlined by Blackstone). Half of the cost synergies are in headcount, with the other half being very clearly defined as coming from data center and real estate consolidation. Management also highlighted the U.K. process of audited cost synergies, which typically leads to more conservative assumptions.

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- **Blackstone's Cost Efficiency Program Well Underway.** Regarding questions on the Blackstone cost plan, management cited inefficiencies in the legacy Refinitiv business, such as 1) 12 layers of management, having since moved down to 6-8 layers - having laid off 2,000 employees and hired 1,000 new, and 2) an average server utilization rate of just 7% when Blackstone acquired. Longer-term, we believe there is still room for LSE to invest in technology to automate 1,000's of data entry jobs that will exist at the pro forma entity. This is not contemplated in Blackstone's savings or the deal related cost synergies defined by LSE and could provide upside to the medium-term EBITDA margin target provided by LSE.

- **Improvement in Desktops Business.** LSE noted that Refinitiv was currently in the process of enhancing its desktop platform (Eikon), including work on a beta version of an upgraded desktop offering as well as an adequate mobile version of the offering. Eikon surprisingly didn't have an adequate mobile offering previously (which speaks to the under-investment in the business). It also sounded like Blackstone has already been talking with some large sell-side firms about potentially introducing an enterprise type pricing model, which would include delivery of data through Refinitiv's variety of distribution channels, and would potentially make Refinitiv desktop revenues less dependent on headcount. Management noted that it would not force this pricing model upon its customers. This could be an interesting move if Blackstone & LSE are successful in driving a pricing change here, as it would alleviate some structural pressure from their sell-side client base. However, it seems like this is still relatively early days, and there is still much more work to be done here before a more dramatic shift would occur. We are also a bit cautious that the dealers would willingly move to a more fixed cost arrangement without getting something in return (for example, fewer pricing hikes on feeds or cloud distribution, or something else). This is an area to watch moving forward.
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Target Price: 7,400p

Risk Factors:
Risks to our price target include market conditions and events that may not ultimately reflect our assumptions and/or projections, adverse regulatory driven changes, credit risks arising from LCH, and legal risks.

Valuation:
Our price target of 7,400p is a blend of 80% of pro forma PT of 7,700p (using 23.5X our discounted realistic pro forma diluted 2021 EPS) and 20% of our 6,150p standalone PT should the Refinitiv deal not pass anti-trust review. Our standalone PT is based on 24.5X our discounted standalone published 2021 diluted EPS, plus 150p of excess debt capacity.

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Note: The boxes on the Rating and Price Target History Chart above indicate the date of Report/Note, the rating and price target. Each box represents a date on which an analyst made a change to a rating or price target.

**Distribution of Ratings/IB Services**

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