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# The London Stock Exchange: Transformed to a tech-driven financial powerhouse



**Jake Thomson**  
Analyst, Multi-Asset



**Rehana Khan**  
Portfolio Manager,  
4Factor

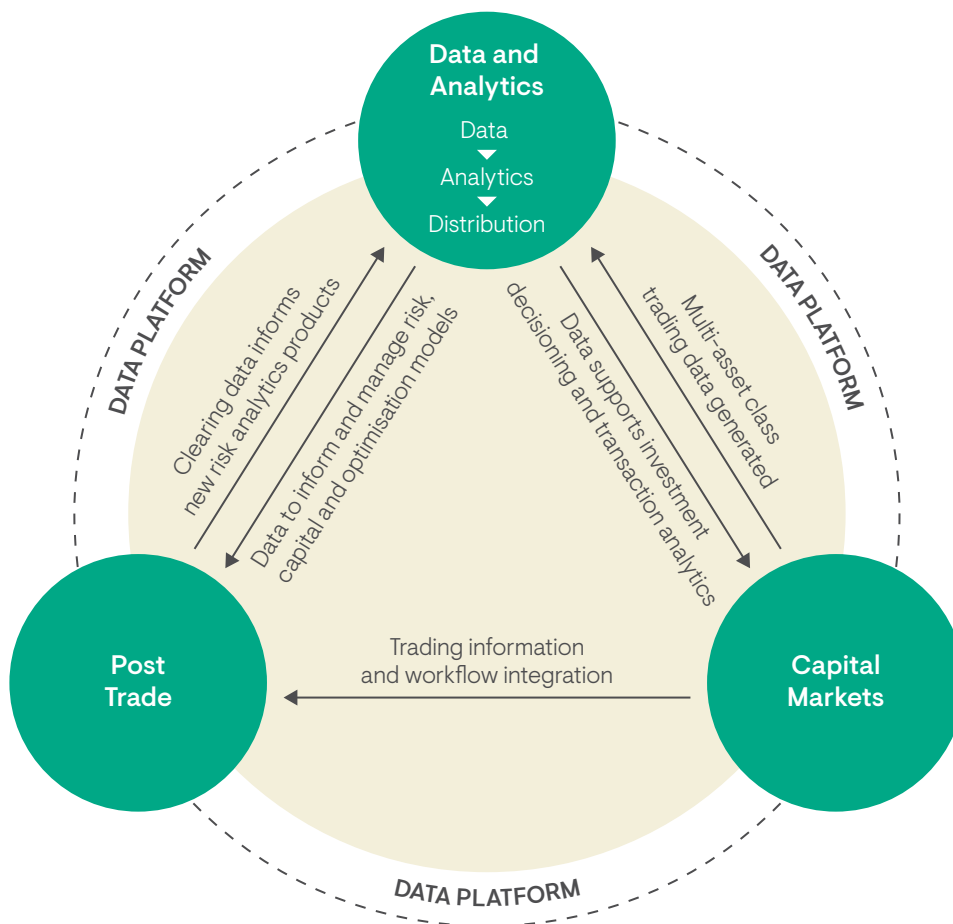
The London Stock Exchange Group (LSEG) is a financial data and analytics powerhouse. Having transformed itself from a traditional exchange that was predominantly a transaction-driven business (capital markets and indices), the LSEG now derives two-thirds of its sales from its data and analytics division after acquiring Refinitiv in January 2021 from Thomson Reuters and Blackstone.

Working closely with our global research platforms, we have identified the LSEG as an ideal investment opportunity for our South African investors. Not only do the share's characteristics of stable recurring revenue streams and high retention rates offset the cyclicity of the domestic market, but the future expansion prospects of the business also provide growth opportunities not available on the local market.

Within the LSEG's core division (data and analytics) sits its enterprise data, Refinitiv desktop offering, and the FTSE Russell benchmark products. These help improve the accuracy of financial decision-making, and in some cases, lower the barrier to entry for market participants. Despite historical underinvestment in Refinitiv, the recent collaboration between the LSEG and Microsoft suggests a compelling case for a substantive improvement in LSEG's organic data and analytics growth rate in the future. Given that LSEG is in a strong reinvestment phase for the next two years, this should ultimately lead to improved returns over the long term.

The LSEG would argue that its suite of products, between data and analytics, trading venues, and post-trade, creates a virtuous circle of connected products, all lubricated by data:

Figure 1: Virtuous circle of connected product offering of the LSEG



Source: LSEG

## What is the LSEG's competitive edge?

As an owner and publisher of core financial data, the LSEG's products are highly embedded into customer workflows. In addition, a growing trend of consolidating data providers and a high cost of substitution means that the LSEG is well-positioned to add further data sets and revenue streams to existing clients, while using its Microsoft partnership to access new customers.

As clients base their own processes or products on the LSEG's data (e.g. valuation data or benchmarks), the LSEG becomes hard to replace. The data and analysis business as a whole is highly 'sticky' with a strong recurring revenue model. It is made up of 90% recurring subscriptions with a 98% customer retention rate. While a lot of its data is publicly available, few players have captured and collected it like Refinitiv, thereby allowing the company to monetise its proprietary model. Refinitiv scores well on the quality and integrity of the data lineage. As the long-term AI opportunity develops, the ability to trust that data matters.

On the capital markets side, an exchange is the quintessential marketplace, where increased transaction volumes lead to lower transactional costs, therefore attracting more volume. This principle also holds true for the index business on which passive investing is based.

LSEG's motto of 'Dictum Meum Pactum' underscores a commitment to building trust in customer relationships, whether in its legacy exchange, index business or the financial data that serves as the engine for its customers' products.

### Microsoft partnership – what does it mean?

In December 2022, LSEG and Microsoft launched a ten-year strategic partnership for next-generation data and analytics and cloud solutions. Microsoft took a 4% stake in LSEG (from Blackstone and Thomson Reuters), while Microsoft's Executive Vice President of cloud and AI was appointed to the LSEG board. The partnership is expected to grow LSEG's revenues 'meaningfully' over time as new products come on-stream.

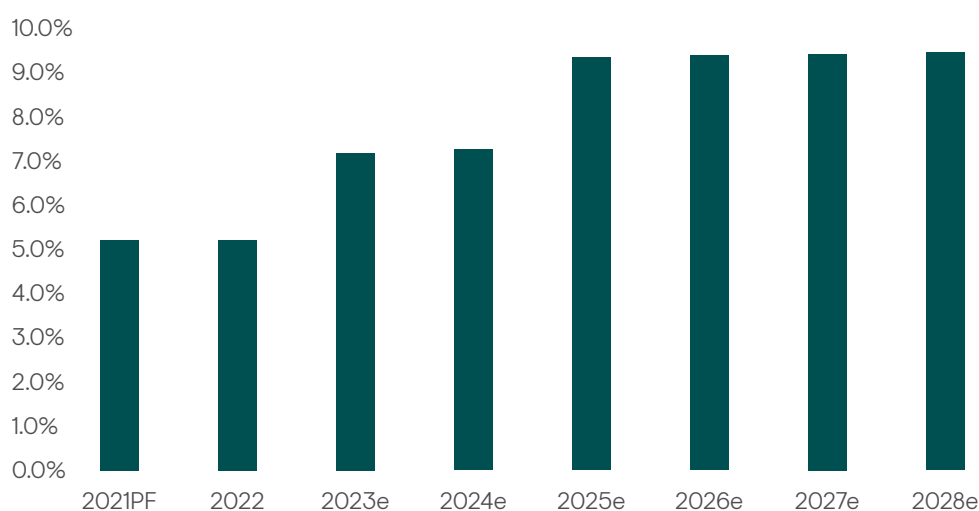
The exact revenue-sharing and commercial pricing terms of the deal are still being finalised. At a high level, Microsoft will be able to expand its cloud business in financial services where Amazon Web Services has the dominant share, while LSEG will gain access to Microsoft's large base of non-finance users. The revenue share aligns with the nature of the products: Microsoft receives compensation for cloud consumption, while LSEG is remunerated for data and its delivery.

As a sign of its deep intent, the partnership has c.500 product and tech employees from both companies working on the new suite of products. Lastly, it must be assumed that the cultural impact of Microsoft, collaborating closely with LSEG, whose heritage is that of a regulated 300-year-old exchange, and Refinitiv, an under-invested and mismanaged data asset, is positive.

## Growth algorithm

Pulling this together, the core business has multiple structural drivers to support upper single-digit growth over the medium term. This stems from the recent product refresh of its desktop product, continued share gains in its ETF and index products, as well as the electronification of the fixed income channel through Tradeweb. Potentially, there is also margin upside as the Refinitiv and Microsoft relationship drives further growth upside in the data analytics business. Thus, in our view, LSEG offers solid growth potential over the medium term that the market is not fully discounting in its forecasts and resultant valuation. This makes LSEG an attractive investment for our funds.

**Figure 2: LSEG's data and analytics growth (lfl) %**



Source: LSEG, Bloomberg, Ninety One; October 2023

## Conclusion

LSEG's fortunes are driven by its ability to provide accurate, trustworthy financial data to market participants to make better financial decisions. As a core financial data provider, its role is to promote transparency, trust and ease of access. As an owner of Europe's largest exchange and an important index provider, its role is to regulate listed companies, ensure fair trading standards and governance, and promote sustainable investments.

The company has a robust competitive position across all of its product lines. It is highly embedded into its customer workflows, as seen by high recurring revenues and retention rates. The significant option value from the Microsoft partnership presents a compelling valuation for a business that is still priced as 'business as usual'.

The South African market is very exposed to many cyclical companies and therefore does not have many companies with quality compounder characteristics like LSEG. In addition, the valuation and earnings do not fully capture the Refinitiv and Microsoft upside benefits to come. Therefore, LSEG offers a diversifying opportunity within our integrated equity selection for our portfolios. Furthermore, given the late economic cycle environment and risk-to-earnings expectations that exist in the markets today, LSEG presents a way to compound value for our clients through this volatile part of the cycle.

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## Contact information

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To reach our Ninety One unit trust team, please use telephone: 0860 500 900 or email: [utclientservicessa@ninetyone.com](mailto:utclientservicessa@ninetyone.com)

To reach our Ninety One Investment Platform team, please use telephone: 0860 500 100 or email: [comcentre@ninetyone.com](mailto:comcentre@ninetyone.com)

Financial advisors: please contact our Advisor Service Centre on telephone: 0860 444 487

Alternatively, please contact your Ninety One investment consultant.