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Intercontinental Exchange, Inc. (ICE)

Sandler O'Neill & Partners Global Exchange and Brokerage Conference

CORPORATE PARTICIPANTS

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

Ian C. McDonald
Analyst, T. Rowe Price Associates, Inc.

OTHER PARTICIPANTS

Richard H. Repetto
Sandler O'Neill & Partners LP

MANAGEMENT DISCUSSION SECTION

Richard H. Repetto
Sandler O'Neill & Partners LP

Okay. The next global exchange to present is the Intercontinental Exchange, ICE, Chairman and CEO Jeff Sprecher. So, Jeff has been the CEO since May of 2000; Chairman since November of 2002. He's known for taking markets both electronic as well as acquiring markets like the NYSE, taking out costs, and really going to where the puck is or going to be in the exchange space.

I also have Ian McDonald from T. Rowe Price, investor in the exchange space, and he's been with T. Rowe since 2007. So he'll his perspective on ICE as well.

So Jeff, I hinted on this, and we have our – we are trying to time this so that the actual fire burns out right when we're done, but my tech guys cannot get...

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

Anybody have a bucket of water?

Richard H. Repetto
Sandler O'Neill & Partners LP

That would get it done.

QUESTION AND ANSWER SECTION

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

So anyway, I try to give a broader intro – a short intro on ICE. But just looking at ICE's evolution, over the last say 15 years, if you look back, where the energy platform focused on transactions, now transactions make up 60% of revenue versus 88%. So I guess, I guess the question is how do you position the story now with what you've built and what you've put together? And are there significant changes still to go in the model, or is it purely executing cost cutting, et cetera?

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

First of all, thanks for being here everybody. And Rich, thanks for having me and Ian as well. Yeah. When we started the company, there was a movement of trading from analog to digital, at the dawn of the Internet, and we were there for that. The business evolved shortly thereafter to the use of clearing and risk management and post-trade services. And it continues to evolve, and we continue to, as you'd say, try to figure out where the puck is going. And increasingly, now, we build – we have trade repositories where over-the-counter and trades reside after they've gone through clearing.

There is a – over-the-counter markets are being organized and cleared, and so they're fragmented markets. But they're becoming more transparent, so there's a bigger need for data. People want to see this, the transparent data that's coming out of these things. And so, suddenly data dissemination is becoming a bigger part of the business. There's just a move to replace most of the people in the room here with computers so that everything is indexed. And so there's – that's a joke, don't hate me for that.

And so that base is going. And so there's just a much more movement of people trying to figure out benchmarks and indices, and so we've been moving in that direction. And so – and lastly, a lot of new regulation coming on, so that impacts customers, that clearly impacts banks, and we're trying to figure out what does that look like when its fully implemented globally, and where will capital flow, and what are the solutions we can provide for our customers. And so, a very, very big investment going on in that part of the business.

So a long-winded way of suggesting you're exactly right. Our business has evolved quickly and taken us to places we could've never imagined when we started it in the year 2000.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

And it seems like there's – you're saying you're trying to position yourself. So if there's gaps right now that possibly don't allow you to know the way you should be positioned, I guess that would be regulatory.

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

Right.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

Or are there other gaps that aren't clear, that you're trying to keep your optionality? You've mentioned the word optionality on your calls. So as you, evolve like how much more of the puzzle do you need? And what are the big pieces of the puzzle that are absent?

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer
A

Yeah. One of the things that we've done that's a little unique is that we have 11 exchanges that we've acquired and they're in different geographies and we don't collapse them altogether and run them as one big exchange. We've kept them geographically diverse, because a lot of us, and particularly in the futures area, enjoy the ability to have 24-hour trading around the world, and a lot of trading was dollar-denominated. So there was no currency issues and it allowed a continuous trading.

But one of the things that regulation is seeking to do is to regulate things locally, and so – and you see this not just in our business. You see Google facing this around the world and Facebook and other major networks and exchanges – just a major network. We're trying to be global, but at the same time we've got to be compliant locally. And it's very unclear how that works out because the regulators are directionally working in the same direction, but they're not necessarily completely cooperating.

Over time, capital is going to move to the places that are most advantageous, and I don't know – none of us know where that is. And so we need the optionality of being in multiple places, because capital – one thing we've seen is capital moves quickly. I don't know how many in this room saw Chinese stocks going up at 20% a month and suddenly said, oh my gosh, we've got to have exposure in 2015 to Asian equities. And when something else starts moving, I suspect people will want to be somewhere else. And we don't as managers know where that is, so we need really try to predict it and be there ready to go.

Richard H. Repetto
Sandler O'Neill & Partners LP
Q

I guess I'm just going to ask, Ian, stepping back when we talk – when you look at what we just talked about earlier, the percentage of the transaction business now being 60%. And also, Jeff has actually – what we haven't got to is the growth of the non-transaction business, which is better strength of ICE's. So I guess my question to you is, how do you view the growth – transactions are going to be what transactions are. They're going to be volatile. But how do you view – Jeff just talked about sort of the data, the listing business, the benchmark business, these other businesses he's done so well at diversifying to?

Ian C. McDonald
Analyst, T. Rowe Price Associates, Inc.
A

I think that's been a really pleasant surprise, and it's additive to the thesis. I mean if you go back a year, you'd say ICE is a business that can probably grow EPS at double-digit rates for two to three years, even if it was just driven by expense saves and capital allocation. There really wasn't a lot of revenue embedded there. So as we – we'd have to – we'd have to wait for the European rate complex to recover.

So I think there's a lot of positives for the non-transaction business can be better. One, it's obviously a steadier source of revenue and a steadier source of cash flows. Two, it doesn't seem like it's – it is proprietary, like there is lot in there that is proprietary and does deepen the moat, so to speak, around the business. And I think it's just that it shows that once you get into a business and you start to collect assets, sometimes someone taking a fresh look at them can make more of them than what they were.

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

One thing – just to editorialize a little bit, when the Internet came in and trading went from analog to digital, what a lot of investors including, I think, Ian liked about our company was we had a fixed cost model in running the technology. So as it went digital, every new digital trade had a high propensity of falling to the bottom line because we had relatively fixed operating costs. A lot of these data businesses and listings businesses and things, they are a fixed cost model that as you add new revenue to, it falls to the bottom line. It's just that the revenue, instead of being transaction-based is being annualized in contracts.

From a manager's standpoint I like that better. I have more predictability, more visibility into the pipeline; it's less driven by daily volatility and more driven by the macro trends that are going on, which we can see. So I actually prefer it, but investors got used to just looking at the analog-to-digital conversion and sort of riding that and – the business is much more complicated today than it was in the year 2000 at the dawn of the Internet.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

I agree. Even four or five years ago, it's much more complicated as well. And when you talk about the growth of these over a fixed cost base, we've worked to getting the right number here, but the growth of the data and the listings business, I believe you've guided to 15%. That's with acquisition and 10% without acquisition, if I'm correct. And that's pretty – that's substantial and can have some – I guess the question is how do you get that – how do you grow the 10% organic? Is it just adding the new users, or is it more screens, or is it charging higher prices, combination?

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

It's not charging higher prices. I know that would be the easy thing, as it really takes last year and multiply it by a price increase, and so that's the next – but our customers had been willing to pay us more, and we have raised prices but we've always raised the content. In other words, we've provided a value proposition that has been seamless, really no pushback on it because we bundled more services.

So the – there's this trend where there's just more data available in the world now and a lot of it is free or somewhat easy to access, somewhat ubiquitous. But our customers prefer to have it packaged and dissected and delivered safely and on time in a way they can manage, and they will pay for that transformation. And we've seen the rise of algorithmic traders, and algorithmic traders have simply been ahead of most of us in taking a lot of data and quickly dissecting it and making a quick, informed decision to do something. We're all heading in that world, but we're not all going to build these algorithms.

People want others to help them take this data and dissect it and figure out what's going on. So I see it as an opportunity to put more service in the network that we already have and create more value for customers, but in doing so, more value for shareholders because we'll be able to price that accordingly. So we're in an early phase of this in my mind, and particularly at ICE, very focused on it because it is an area that people are willing to pay for.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

And you would include ICE Benchmark Administration in that category?

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

Yeah. So, ICE Benchmark Administration took over the LIBOR setting. It took over the Gold Fix and now the ISDAFIX, and it's talking to others about other benchmarks. I think most people didn't realize that you always needed a LIBOR license, that when it was owned by the banking association, that got lackadaisical; it wasn't always enforced; it depended on who, what, and where as to what the license would be. Now it's going to be very standard, which is everybody needs a license, pricing is going to be transparent, and we expect that what we're doing around LIBOR is making it a better benchmark. So we're strengthening it as we strengthen it and as it gets used more and more and reintroduced in more systems. Because it has standing, we think that we're going to get more and more people licensing it.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

So the ability to monetize it will go up?

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

Will go up. On top of that, we have these other benchmarks that we've added. And even if you gave it away for free, people want to know, people would like to see how does it build up during the day. Can I get access to that transparency, can I get secured delivery of it at a moment in time in a place that I need it to be, in a system that I need it to be in. And there are other services that go around data that we're starting to work on and monetize. And so I think it's early days in a very nice scalable network business, not just because we will raise fees, but because we're going to deliver a lot of other services.

Ian C. McDonald
Analyst, T. Rowe Price Associates, Inc.

A

One point that Jeff forgot to mention is that I think technically you paid a £1 for the administration or….

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

£1, yeah.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

So, pretty good return.

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

Very good return. We're investing a lot in it, don't get me wrong. I bought – I started ICE by buying a failing company for $1. So I've been down this is and – well, we've invested a lot in it. And we are going to invest a lot in Libor, but it's going to have a very good return.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

So now given the asset diversification, again it's 60% is transaction that was not 80% or 88% like it was before. But I think people still look broadly at the asset classes, energy, interest rates, equities, et cetera. So I guess the question is which of the asset classes do you think over the – have the best growth potential over the – and you could actually exclude, like, say natural gas. I know that's cyclical. You could exclude that if you wanted to. Would energy be ahead of – we know we're all hoping for interest rate volatility.

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

It's hard to know, obviously. We've been in energy since we started the company in year 2000, and it's been growing. And we just have continued to set records for oil trading year after year after year. And every year, I said with Ian in the assets, this is the last year and we're out of – there's a super cycle for commodities, and now it's over; or commodities are out of favor for investment, and yet it just grows year after year after year. And we reported in our last earnings call that we were just surprised at how many new user IDs we're getting and people that still want to have exposure to oil even this many years after we digitized it.

But I don't know the answer to that question. What I do know is that there is a trend in clearing because of capital constraints to have multi-asset class clearing houses that can handle a lot of different products. People want to have basically kind of one-stop shopping with some competition so that it doesn't become usurious.

And so it's important to have every asset class built out in these systems. And the collateral is going to be constrained, people that never were margin before are going to have to pay margin, and we're already starting to pay margin against trading. Bank balance sheets are going to be constrained, and the clearing house is going to pick up a lot of that stress. And people really want to have an overarching multi-asset class place that has very good collateral management.

So we almost don't have the luxury of choosing what asset class we want to be in. We need to be in all of them, and we need to be good at all of them and have infrastructure for all of them. And that's what you've seen us doing. We got ahead of that curve, as you mentioned in your kind introduction, and are sitting in a very good place globally for that.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

And when you've talked about being in all of them, one, I think, that everyone speculates around and talks about maybe gets more attention than what the numbers would deserve is the NYSE.

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

Right.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

And I know the growth rates of the EBITDA – I think it might be your fastest – would cost cut your fastest-growing sector. So, I guess the question is here's the debate. Even it is contributing to earnings right now and growth of earnings right now and it's certainly a road – a path laid out or even more, but at the same time, as you make it as you skillfully do – make it more efficient standalone, how you look at the sort of the tradeoff where you can potentially spin it out even if you do like the business? If you don't like it, it probably makes it a lot easier, but the business is going well. Now, how do you look at – is it a value decision?

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

I'm not wedded to any business we own, so I wouldn't pick that one over any other one. We want to – we tell Ian and people, others that own our stock, and he's graciously owned us for a significant amount of time and been a very good long-term holder and very constructive dialogue back to management, that we want to grow earnings double-digit, and that's our goal. And we want to do that day-in and day-out. We are a growth company, and we're owned by people that expect us to grow. And my compensation and that of the entire company is tied to delivering growth. And so, that's our goal. And if something is a lag on that growth, then we don't want to own it. And if something else is out there that we can buy that we think we could be additive to that, we'll buy it. And if we can do it organically, that's our ultimate goal.

But I would just say about the NYSE, I understand that that company had an 80%-some market share, and because of regulation and introduction of more competition, went down to 20%. But since we've owned it, market share's coming up, costs are going down. We're doing fabulous in listings. It's been a great IPO market for the last few years. We lead in tech IPOs where we used to be thought of as a large industrial listings venue. We are now – really great tech companies are coming, which is where a lot of innovation and growth is in this country particularly. So that company is just – it's almost hitting on all cylinders, so it's hard to say anything negative about it.

There's this movement that I mentioned towards passive investment. A lot of those index funds in ETFs really just care about the closing price. We run a very good auction at the close. That volume is increasing, which has been great for us. We've decided, well, heck. If we're running an auction at the close and running an auction at the open, which is very kind of unique for us, the way we do those auctions, why don't we run them during the day? So we've got SEC approval now to introduce auctions. So we're changing the business model. We advocated for and received approval for this thing called the tick pilot, which the SEC has instructed us to introduce into the market. We will be the lead in drafting the rules around that, inviting the other exchanges in.

But I really think the data that will come out of the tick pilot will help inform market structure changes. I think a lot of people don't recognize that the market structure that in the United States today is a pilot, and this is now a new pilot. So when people like to say, well, this will be five years or six years out, I'd like to remind them that the pilot that we're in right now, it worked and just kept going, and if we introduce this new pilot and it works and keeps going, I would expect that – and it works for you all investors; I would expect that it would keep going.

So I'm very excited about the environment around the New York Stock Exchange right now. And it's been a really good thing to own, and our timing turned up to be fortuitous in that business segment.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

And who knows, the equity business as well. Very well. So what do you think ICE could do with the...

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

Well, as I look at it, I mean it's an asset that probably is going to deliver cost saves for another 18 months or more. So that shouldn't be ignored in terms of value creation it has and also delivers a lot of free cash flow in the United States, which is important, increasingly important.

And as I look at it, I think there's also this embedded optionality that maybe there is a grand bargain out here somewhere, and maybe the market structure does dramatically change, and we have a defragmentation or consolidation of volume and fewer venues, and it becomes a better business.

So in the near term, it's delivering cash flow, and that cash flow's rising as you take out cost and make it more efficient and improve the asset. Once the costs are out and you've harvested that, you can make a call on what does this business look like in five years. And maybe you keep it depending what that pictures looks like, or maybe you spend it.

It's also – it's such a unique asset, I think, and this might pan out that it's almost like a football team or a baseball team, like there are lot of people who want to own certain iconic assets and it's not an economic decision always. So, Jeff Bezos buys The Washington Post; not necessarily an economic decision, but an asset that he cared about and wanted to foster. So I think there's a lot of optionality here from a lot of different angles.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

And I think if you look at what you paid given what you've spun out and the cost save, it's looking pretty economical right now.

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

Yeah. We measure all of our acquisitions and our share buybacks of our own stocks against where do we get the maximum return on invested capital. First of all, it has to be above our cost of capital, and where do we maximize our return on that. And we think we'll back above our cost of capital here shortly, and it will be – have been an amazing – this was dilutive to us because it was so big, but we will quickly get the returns out of it, and I think within a short period of time be well above our cost of our capital and growing. It's great.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

We are – we are limited on time, but the one thing I did want to bring up that you brought up on the last call in regards to valuation and sort of the earnings growth rate versus the multiple. And you skillfully pointed out that ICE may not be – from a peg basis, was lower-valued than some peers that that may not be growing as fast. So I guess the question is what you can you do further to make the case on valuation? Is there anything?

And, Ian, also your opinion on how investors look at it in the current – you trade somewhere between, to mention specifically, NASDAQ on the lower – something in the middle between the NASDAQ and CME and CBOE.

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

A

Well, in our investor presentation and in our last earnings call, we put a chart up of the earnings every full year that we've been a public company, which is nine years now going on our tenth year. We've grown earnings all through the financial crisis, through different kinds of environments in the commodity cycle. Like we've been very, very good at growing our earnings. And in that regard we are a growth company. So when we think about – we're generating a lot of free cash right now, and growing. And so how did we deal with that capital? And so we look at investment opportunities in the business and we look at dividend policy and we look at share buybacks, and run all of that through a return on invested capital model and try to figure out what's the best use of our cash at any moment in time. And the comment I was making on the call was really that it's been easy for us because we think that the best return for us is to buy our own stock right now.

I think really good companies are dividend payer – good companies with good free cash flow are dividend payers, and they grow their dividend over time, and are consistent in their ability to grow dividend. So we also announced a dividend increase. It was sort of the – we just started paying dividend, so this was our first increase. And I think hopefully it'll be the first of many because I want to put that kind of discipline around the company as long as I'm the Chief Executive. But then the free cash is – what else we do with it. And so far it looks – our stock looks like a very good return to us.

Ian C. McDonald
Analyst, T. Rowe Price Associates, Inc.

A

I guess I'd probably make three points. One is if you break the company into pieces and look at it granularly and apply public and private value to the pieces, you would get to a higher multiple than it's at today. You'd also say, I think it's fair that there are several assets here that are probably not valued right or not contemplated in the current valuation. So, NYSE, Benchmark Administration, the Brazilian assets, Singapore Exchange – these are all essentially call options that seem like they're pretty cheap today.

And lastly, I think, a key part of the company gets bigger, a lot more of the value comes from capital allocation. So the returns basically – the framework is, if anything, increasingly important. That becomes a bigger part of the picture.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

The log has burned down, not enough, but gone. But I would like to sit up here and dissect the company by value point by point, but we just don't have the time. And you certainly would love not to hear me – exactly. I don't think you have the patience, although it probably would be a beneficial exercise or a positive exercise. But I want to thank Jeff and Ian. ICE is certainly an exchange in every – if you're in the exchange space, you're going to monitor not only what goes on with the NYSE, the continued cut from a regulatory standpoint, and how you've diversified all over the growth. So it's an exchange to watch. I'll leave it at that.

Jeffrey Craig Sprecher
Chairman & Chief Executive Officer

Thank you. Thank you, Rich.

Richard H. Repetto
Sandler O'Neill & Partners LP

Thank you.