09-Jun-2016

Intercontinental Exchange, Inc. (ICE)

Sandler O'Neill Global Exchange and Brokerage Conference

CORPORATE PARTICIPANTS

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

OTHER PARTICIPANTS

Richard H. Repetto
Sandler O'Neill & Partners LP

MANAGEMENT DISCUSSION SECTION

Richard H. Repetto
Sandler O'Neill & Partners LP

Okay. Our next presentation, we'll come back to the U.S. after visiting Asia in the last hour-and-a-half. But the next exchange is the Intercontinental Exchange, better known as ICE. The Chairman and CEO, I think most everyone knows, is Jeff Sprecher. Jeff founded ICE in 2000, and I won't go through the myriad of transformations – acquisitions and transformations you've done to get it to where it is today, but we're pleased to have Jeff. And I guess the first question that comes to mind at the start and we followed a general outline of talking broad, getting more specific and then, now we can talk. These log, we won't even comment on the logs.

But for ICE and you should know the demand to meet, and Jeff and I just talked about it. It's just higher than any year it has been and I would say, at least from my standpoint, potentially it could be a pivotal moment in your history and there's been, and if you look back at what ICE has done in the past, it has been pivotal moments, when you bought the IPE, when you bought NYBOT during the financial crisis. And I guess, I'm just trying to – and you've always been ahead of the game in regards to sort of seeing where the puck's going to go, and where it is right now.

QUESTION AND ANSWER SECTION

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

So, my question is do you see this as a pivotal moment, yourself now and if so, what makes it pivotal now?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Thanks, it's nice to be here, by the way. I don't see it so much as pivotal as kind of inevitable. My company has, if you think about year 2000, when we started with the height of the dot-com boom and everybody was talking about the use of the Internet, and we started a company to use the Internet. And we just followed the offshoot that has come from the adoption of more electronics in financial services since year 2000.

So, it started with an analog-to-digital conversion of people that were trading and no longer using telephones, but using screens. And then we could see, as things were standardizing and becoming digital, they were going to be cleared. And now that electronic trading and clearing is so pervasive, we can see that more and more people are doing analytics. New kinds of investing around ETFs and ETPs, new kind of advice with so called robo-advisors consuming data, new ways that endowments are allocating investments both geographically and through asset classes instead of the old 80/20 equity bond portfolio.

So I think all of that is kind of a continuum of the change in financial services that technology has been bringing. In my mind, we are a technology company, and all of the businesses that we go into are ones where we think we can build a single technology and then sell the outcome over and over and over again so that it scales at high operating margins. And unfortunately, for many of you that are in the game of investments, the way your business is evolving is changing very rapidly. Maybe I shouldn't say unfortunately, I mean, fortunately or unfortunately, it's changing. And those that can adapt to it will do very, very well. And we're providing tools for those that are moving quickly.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

So – and just take a look at the change and I think you're referring to, I guess, increased demand for market data.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Right.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

And that can be driven by the types of traders, but I'm just trying to get your view, who have studied these markets and been ahead of the changes, is this the last one? Is this – maybe it's not quite pivotal, but is it regulatory driven? Is it competitive driven? Is it automation driven? But what's gotten you to move – to make the moves that you have?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer
A

Yeah. If you were to ask me in year 2000, when we started the company, what do you think, why are you doing this? I would've said I think markets are going to become more automated, more standardized and more electronic and clear. We started the company with that vision. And if you ask me today about regulation and about the changes in the market, what's going on, I would say to you, it's all driving those exact same things.

So, I'm not sure that we're reacting to regulation as much as regulators have sort of caught on to the trend and are just now another voice that's promulgating those trends that were already in the market. It's pivotal in that my company is bigger and we have more ways of earning money and growing. But the original business that we started is still growing really well. And so, we've continued to add on great growth businesses that follow the electronification results that are going on right now.

But I started with trading and then we moved into clearing and now we're moving more into data and analytics. And all three of those are growing, it's great. And they're kind of growing at the same time in an odd way, they're holistic to one another in that it's a similar customer base that's consuming all of these things. So we're able to cross sell and cause them to grow together.

But it's pivotal in that my company is a big company now. It's really become part of financial services infrastructure. It's really – people will take our calls and people are willing to have meetings and people are willing to – you're willing to come into a room and listen to me pontificate. And I guess it's...

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

I've always been willing to do that.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer
A

Yeah.

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

But positively.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer
A

So, anyway – so in that sense, it is a much different company than the one we started.

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

And I think you assume this, but I think the focus on data in the analytic sense, it is a logical offshoot to you. But I think now, with the big acquisition, it shines a bright light that this is part or is going to be a part of the exchange business going forward.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer
A

Yeah. If you think about the markets that – before they were really electronic, there were certainly exchanges that put out consolidated tapes and they were geographically located. So you had the Chicago Board of Trade, Chicago Mercantile Exchange, Chicago Board Equity Options Exchange, New York Stock Exchange, New York Board of Trade, London Stock Exchange, London International Financial Futures Exchange, International Petroleum Exchange of London, Hong Kong Exchange. In other words everyone had the name of the city in their venue. Why? Because they were really very regional, and the closer you were to that region, the closer you were to the information and to the point that if you really wanted real-time information, you needed to buy a seat and stand on this floor. And what's happened with the electronification and partly why I name the company Intercontinental Exchange was that we no longer have any geography.

So markets now are consolidating around these large exchange operators like ICE and a number of our peers. And we now have a lot of global data and its electronics. So it's easy for us to give it back to you. So where it used to be very, very hard to get this data because you had to go and be in all these locations. Today, that data is coming to us. Now, with the regulatory mandate that even some of the most esoteric over-the-counter market needs to come into clearing. The clearing houses are the aggregator of that data. So it just makes sense that you've seen this exchanges, first of all the data businesses, the organic data business, a lot of exchanges have been growing and mine has been growing since the day we started the company.

But we just had more data to sell you and you're probably already a part of our network. You probably already have some connection to us. So we already have the ability to give that data back to you in some ways. You lay over top of that this trend in the different style of investing where there is this past investment moving – movement of people investing in EFPs and there is this robo-investing going on where people are getting customized and the spoke advise that's based on data that's germane to you and – Rich, you and I may get two different pieces of robo-advice on where we should invest. And then you look at our audience here, which probably years ago had a U.S. mid cap, U.S. large cap, international fund kind of behavior. Now, people are looking for alpha and beta around the world, the investment strategies are borderless now. And money is moving seamlessly and the style of investing has changed so much that people are differentiating their selves by coming up with different kinds of portfolios that include more than maybe just equities or fixed income and certainly have no geographic boundary. So all of that, those trends are consuming data.

Today, if you or I in our kitchen want to buy some product and we click a mouse to do that, it probably will end-up going through some kind of algorithm and that algorithm maybe collocated in one of my data centers. And so the sophistication of the way we route and consume trading and risk management now is just all of that together. It's just an unbelievable consumption of data. The last thing I would say to you, if you just think about your own personal behavior, you probably have a smartphone in your pocket and you probably have increased your data plan recently. And if you haven't, you are of the mind that I suspect that you'll be consuming more data in the next few years than you did in the past few years, because – and it's all kinds of data that are going in, that now you and I in our pocket have the capability of manipulating and coming up with some results. So it's definitely a growing space, and it's an amalgamation of the fact that so much of what we do now has just become automated. And my company was at the forefront of certain markets, some of the automation that went on. So it's kind of a natural extension for us.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

So, we just – I don't want to beat this to death, but one last question on the data side...

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Sure.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

...because, again, it is a big component. But if you're looking at your revenue now, half a bit will be recurring revenue. And this is, I think, symbolic of the importance of market data. You actually break it out when you report.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Right.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

So – and then you break it up between pricing and analytics, desktops and connectivity, and exchange data. And I'm just trying to get a feel from you. You talk about data being a growth – still a growth vehicle and ICE being certainly a growth company. But which area should we expect to see the growth in market data?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

It comes from all of them. And I hate to – we've designed the business that way because our exchanges have continued to grow every year that we've been a public company in year 2005. We have a compounded 20% earnings growth rate in this company and since we're a public company and it's pretty consistent as you know.

And so, the underlying business of trading and risk management has been growing for a decade, continues to grow, grew last quarter, grew all through the financial crisis. You just don't see any end to it. But then, in order for you to risk manage or speculate in a market, then you want to do analytics, and then how do you want me to deliver those analytics to you, what kind of network, what kind of database do you want us to use.

All of that is sort of, again, synergistic in that one doesn't grow sort of without the others. It's all – we break it out because we have these various businesses. But when we go in and talk to customers, the first thing is, do you want the base product? And if the answer is yes, then it's, how do you want us deliver it to you? When do you want us to deliver it to you? Oh, by the way, we have other things that are similar, would you like to see those, and so on and so forth. So it – we've only really been in this business in the scale that we're in for months, but we've already seen the huge demand when we talk to large investors, particularly.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

Great. So to switch gears a bit, competition. So you've stayed ahead of the game consistently. But when you look at some of the markets now, whether it be energy, you have the CME and WTI. You got a startup platform in NFX. If you look at ETF listings now, you've got a new [ph] batch of (14:55) public competitor very much targeting EPS. And they have good trading share, and you have a big competitor – or potentially a big competitor in Europe emerging. So how do you view competition given what looks like a tougher line-up here?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Yeah. Well, let me go back to what I said before which was, a decade ago, when you had these regional businesses, they didn't really compete because it was hard to go into some other region and start an open-outcry trading floor and get telephone lines and people to show up and so on and so forth. When we went electronic and then as these large exchange groups like mine formed up, the reality is, not only are we borderless, but we can list each other's products. So, what you're seeing is that all of us are listing each other's products.

And what does that mean? Well, what it means is that we're taking markets that were relatively vertical and we're fragmenting them – through competition, we're fragmenting those markets. What happens when the market fragments? Well, you all in the audience want to – when you go to do research, you want to see what is the price and, i.e., what is the best price. And when you go to do a trade, you want to source it to where the best prices exist.

Well, when we fragment the markets, it becomes much more difficult for you to see the best price. And so, you will try to reassemble that market. Well, how will you reassemble it? You will buy data. You will want to get on networks that hook to that data. You will want to co-locate so that you can get the data in real time. You will want analytics that reassemble the data. And when you go to trade, you're going to want algorithms that search out and go across those same networks into those same data centers and look for the best price.

And then HFT traders are going to realize that there are two different markets there and they can't possibly be tick for tick at every moment in time on top of each other. So, there is arbitrage that will happen where somebody can buy in one market and sell to the other market. So overall volume goes up as a result of the fragmentation. And demand for data goes up; demand for networks goes up; demand for algorithms go up. And so, what you and I've been talking about in this data space is kind of a natural progression of the competition that's going on.

And all of us that compete are – while we may "take market share from each other," what we're really doing is we're growing the market. We're growing the market for trading; we're growing the market for data; we're the growing the market for analytics; we're the growing the market for access. And that's why all of our companies are growing. And so you'll hear a lot of my competitors talk about market share. And if you really push them, you'll find out that they're losing money on whatever it is that they're doing. But they've overall grown the market and they're making money elsewhere and we are making money elsewhere.

So I advocate a lot that I don't – we have this other interesting trend which is particularly in Europe, government is trying to stimulate more competition amongst these big verticals. In other words, government itself is trying to fragment the markets more to give you more choice. But you will have more choice in places to do business. It's just going to cost you a lot more because you really honestly won't be able to do business having that choice without paying a lot more in order to make sure the choice you're making is the right choice. And so, all of those trends, I think, are going to continue to drive the buckets of data that you described that we have and there will be more competition around it; but overall, the pie is getting much bigger.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

And we'd mainly talk to like – regulations like MiFID II.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

MiFID II, which really wants to unbundle trading and clearing, thinking – I think what happened was politicians in Europe went out and asked people like you, would you like to have more choice in where you do business and you naturally said, yes. They also asked you, would you like to be able to buy research from whoever you want to and have that unbundled and you said, of course. They asked all kinds of – would you like this? Would you like that? Nobody ever asked, how much more are you willing to pay? And there was certainly not a study done of that. And the net result of this regulation is people are going to have a lot more choice. It's just going to be a lot more expensive and more complicated and harder to do business. And we're setting my company up to benefit from that. And to – of your increased spend, we want to get our part of it. And I will tell you that overall, the cost of execution will go down. So people that like, for example, the U.S. equity market structure will tell you, boy, it's much cheaper to do business on the New York Stock Exchange today than it was years ago when it was the dominant player and it really is.

The execution fees on the New York Stock Exchange are a fraction of what they used to be when it was the dominant player. The New York Stock Exchange last quarter had the single best quarter in the history of the 227 years of the company in both revenue and earnings, following on the best single year it ever had the year before. So, yeah, our execution fees are low. Yeah, there is massive competition for equity execution; but the spend that we're able to capture while people look for best execution continues to go up. And so the company's market share is low, but earnings are way up. And I think that – that is the trend that you will see. So, I would just say that you all – the way I look at the company, I don't really care what our market share is. I look at – I don't care if it goes to 1%, I look at are we growing our revenues, are we growing earnings, have we positioned the company in the place where the spend is moving to? And the spend is changing with the competition that's coming from the digitalization of these markets.

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

Great. For no particular reason, just want to throw this question out to you. Are you..

Jeffrey Craig Sprecher — A
Founder, Chairman & Chief Executive Officer

I don't feel any pressure on the answer though.

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

Are you able to cross-margin or get portfolio benefits between two clearinghouses that are in two different jurisdictions that don't intend to combine?

Jeffrey Craig Sprecher — A
Founder, Chairman & Chief Executive Officer

No is the answer and I'll tell you why because the clearinghouse exists for one reason and that is when somebody defaults, it is there to protect in the event of a default. And normally when somebody defaults, they go into bankruptcy. And the clearinghouse is bound by the bankruptcy rules of the jurisdiction that it's in.

And so, when MF Global collapsed, our – the German clearinghouse which had positions liquidated them on the Monday morning that the bankruptcy was filed. The UK clearinghouses, of which I had one, started arranging for trades – new counterparties to come in and take the position of MF Global, keep the trades on, but change the counterparties. And the U.S. clearinghouses, of which we had one, was ordered by a trustee to freeze. Exact same kind of customer base, very well established bankruptcy regimes in three different places, three different immediate eventualities.

At the end of the day, most everybody got their money back through different processes, the timetable was different, the process was different, the result was the same. The point is, is that bankruptcy regimes in these different areas is different. And at the time – at the critical time that a clearinghouse has to perform its job, they are different. So, no one has yet figured out how to take a long that's in one jurisdiction and a short that's in another jurisdiction and give any kind of an offset because it doesn't work at the critical moment of default. And the regulators are well aware of this and cautious in experimenting.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

So I was asking that for no particular reason. But see...

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

By the way, we have six clearinghouses around the world and we really are thinking a lot about this and have for years, and we would like to find a solution to it. It's just – and if somebody can figure it out or if we can figure it out, we'd be a big beneficiary of it and our customers will certainly benefit from the infrastructure we've built. We just haven't been able to figure it out and we certainly haven't been able to convince our regulators yet.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

Just one follow-up and I'll move off of this topic as well. What interests me is what you just said, the regulators. So, you've worked with them, you have – they haven't been able to figure out. So, that tells me that if someone was to have a plan and that they – even though they can't give you the plan right now, but to say that they'll be able to work it out with the regulators...

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

It's possible. We have – there are some minor places, for example, we have futures on the Russell indices and the OCC has Russell equity options. We have a deal – and they're both in the U.S. And we have a deal with them that if you have a future on ICE and an equity option position on OCC, you can get an offset. And people like to throw that out as an example. What they don't tell you is that you have to – the position has to be approved by the SEC and the CFTC. And the person who's involved has to prove to those people that it's not material to the system. And we and the OCC have to demonstrate to the regulators that if they were to default that it's a de minimis position, that wouldn't impact the kind of thing that I said.

So, it exists. It's just that if you think about, is it meaningful, no, we can't really make it scale because the regulators don't want us to take – if you think about offsetting, what you're really doing is holding less margin money in the system. So the people we've been able to run through that gauntlet tend to be market makers that are instantaneously liquidating positions and don't hold any real position so that, at a moment of bankruptcy, they really don't have a material position. But even to get that done, it takes a lot of regulatory work, and that's just in one jurisdiction on one really kind of small asset class.

The thing that we're all trying to figure out is bank capital is getting really tight and can we meaningfully come up with something that would reduce the capital that banks hold. And to do that, you're taking some asset classes that are pretty material to the world and you're going to be trying to reduce margin for the people that the regulators are most sensitive to, and so it's not an easy solution.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

Thank you for clearing that up for me because I had no – just was wondering about it at night by myself.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Amazingly, no one else here was and they're all yawning.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

Yeah. [ph] Many people get it soon really (26:35). I guess, we've got a limited amount of time here. Probably, last question or, if not, the last question, the – on valuation. So, I think everybody understood that when you were going to bid for the LSE, at least it was risk from an investor standpoint of what it could tax on your balance sheet.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Right.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

That's gone away. I think there is regulatory change risk built in to some extent even though I think you've answered – addressed that. And I think you've addressed the growth. But anything else, reasons that – or things that you would address to try to understand the valuation of where it is right now, say...

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

Yeah. It's hard for me as a manager to know what my stock is worth. All I can do is tell you how we're thinking about running the company, which is what I'm doing here today. But we have moved into a number of really high-value businesses that have strong recurring nature to them that, for me as a manager, are much more predictable and that I have a lot more influence in stimulating their growth.

So, I like the new businesses that we're moving into. I can go home at night and know that things that we can do as employees in the company are falling right to the bottom line. As opposed to a lot of the trading businesses, you depend on volatility which you have no control over. So you build the infrastructure so that you're there at moments of volatility. And for us, the businesses that we're in tend to have a lot of volatility. We've positioned – we've curetted our positioning so that we're in volatile places where we've had year-over-year-over-year growth.

But I never really know when it's coming. What I like about these new businesses is they're very predictable, high-value. And the great thing about all you in the audience is that you love to benchmark yourselves, looking backwards, one year, three years and five years. And so once your data is in that system, once my data is in your system, it's hard to remove it because if you remove it, you won't be able to look backwards five years. You're going to have to – you've already built a track record against this and you're going to have to explain to yourself and to others why you changed the data set. And a lot of times, people think so that means that you were trying to move the goalpost; so it's very, very sticky.

Also, as you build analytics and trust around the data that we provide you, your workflow tends to use that and time and time again and you'll go to what works for you. So this stuff is very sticky. If we can form good lasting relationships with the buy side, I think you're going to see over time people will appreciate – I hope people will appreciate the high-quality earnings that we've put in the company; I certainly do.

Richard H. Repetto
Sandler O'Neill & Partners LP

Q

We have high demand for one quick question, I guess [ph] follow up (29:52).

Q

You bought IDC; that's given you set of capabilities with respect to gathering data, analyzing data, reaggregating data, selling data. As you guys meet the demand from your relatively newer, because your historical relationships have been with the sell side, right, your relatively newer buy side clients. And as you meet their demand to reaggregrate the data that has been fragmented because of what's happened in the market structure, is there anything that you're not able to do along that? How you handle the data food chain with IDC that you need to go somewhere else to get or can you do everything you need to do under the IDC umbrella?

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

A

That's a good – great question. First of all, the answer is we've got everything we need. That doesn't mean that we won't look for opportunistic acquisitions if it can accelerate things or if one and one will make three for us and we've done that through the history of the company, as you know, [ph] Larry (30:55). One point though that I would underline that's a premise of your question that you may not realize is that in the exchange business, when a buy-side firm like yours would trade or clear, the payment collection that we would get from you was through an intermediary, through your broker who would – we would actually bill and then they would charge you and then we would receive that revenue back through the clearinghouse as margin money and fees we're moving. And one of the things we have now with IDC is not only the ability to talk to you directly, but we have the infrastructure to have a direct relationship with you in terms of billing, in terms of a sales force, in terms of contract negotiation that we didn't have before.

So, it's paid dividends already. We announced in the first quarter that we've owned IDC, that we're working with BlackRock on a whole new series of businesses around ETFs with AllianceBernstein, on a whole new series of businesses around compliance tools. And so we have the capability now of actually having money movement and product movement between the companies that we didn't have before. So, we hope that we can take lots of other things we do in ICE and use that infrastructure to deal with all of you on the buy side that are here directly.

Richard H. Repetto
Sandler O'Neill & Partners LP

Our time is up, but I would say at the risk of repeating myself, when Jeff says he likes a business, I pay attention. He said, he liked clearing in 2006, I'll leave it at that. I want to thank Jeff for taking the time and meeting all the investor demand and then keeping us thinking on our feet here.

Jeffrey Craig Sprecher
Founder, Chairman & Chief Executive Officer

Great. Thank you very much everyone.

Richard H. Repetto
Sandler O'Neill & Partners LP

Thank you.