February Article

What can be expected from a Deutsche Börse-LSE merger?

The German Exchange Group Deutsch Börse is already in advanced talks with the London Stock Exchange (LSE), regarding a merger deal that would create a global player worth at least GBP 20 Billion (USD 28 Billion). The result would be the creation of a globally competitive European champion in derivatives, clearing and financial market data, that could better compete with bigger rivals. The new group would become Europe's main answer to Chicago's CME Group, Atlanta's Intercontinental Exchange and Hong Kong's HKEx. Under rules guiding UK takeovers, Deutsche Börse has until March 22 to table a firm offer for the LSE or walkaway.

This is not the first attempt to merger these two Exchange Groups, as two other attempts have failed before. The first try in 2000 was ultimately spiked by a rival approach, and a second go in 2004 failed mainly due to the aggressive attitude of Werner Seifert, Deutsche Börse's boss at the time, and also of some of its big shareholders. Despite the failing of the first two offers, both the two groups are a lot different than then were 15 years ago a lot due to the guidance of leaders or previous leaders who highly improved the situation of the groups 10 or 15 years ago. Under the leadership of another ex-banker, Xavier Rolet, the LSE diversified away from the thinning margins available in its core share trading business, into indices and clearing. Deutsche Börse by contrast had sat back under its last chief, Reto Francioni, though Mr Kengeter compensated, spending EUR 1.5 Billion on acquisitions within weeks of taking the top job last year. Although there are other possible offers to LSE and a bidding war for it could mean bad news for the German group, as its balance sheet is already stretched out is stretched already (due to a high debt to earnings before interest, tax, depreciation and amortization ratio), the merger between the Frankfurt and the London based Exchange Groups seems the most likely at the time. Börse's main competitor, Atlanta-based Intercontinental Exchange (ICE), faces political and regulatory hurdles and may have to make a hefty offer if it is to walk off with London's biggest exchange asset, so although it is a possibility, it is a difficult acquisition to take place, and there is still no specific offer by it. Share price increased in both Groups at the time of the announcement, with LSE shares up 15 percent and Deutsch Börse up 4.5 percent with the announcement. Also in other some other Exchange groups, the new was good received, as Euronext shares were up 4.8 percent and Spanish exchange operator BMW stock rose 2.3 percent. The numbers show confidence in the merger and support of both markets and the investors.

Global regulations have forced banks and large users such as hedge funds and asset managers to place billions of dollars of collateral and margin as insurance to back their derivatives trades. As a result, billions of dollars of capital are being held at clearing houses. Bringing the clearing houses under one roof would allow customers to net their margin for swaps and futures. That is why the London Stock Exchange and the Deutsche Börse said last week that their merger would have "significant customer benefits", including reducing margin costs by netting them within one organization. Even Moody's, the credit rating agency, said an LSE-Deutsche Börse tie-up would be positive for bondholders and a credible rival to CME and ICE, "albeit at lower relative margins". The deal would involve moving the LSE's interest rate derivatives business subsidiary SwapClear into Deutsche Börse's Eurex futures business and use the German group's technological platform. SwapClear, as the world's largest clearer of interest rate derivatives, has emerged as one of the winners from the financial crisis. By merging it with Eurex, it would ease banks' growing capital requirements by allowing them to net their margin payments for futures and swaps trades.

Both companies have downplayed any risk from Brexit, saying last week that the proposed merger would prosper regardless of whether Britain stays or leaves and that the array of trading and services on offer in Frankfurt and London would not shrink as a result of the merger and Deutsche Börse even stated that it deliberately launched its bid for the LSE amid the political uncertainty surrounding Britain's referendum to steal a march on US rivals. It was stated by both exchanges that if the UK did vote to leave the EU the volume of trade in London and Frankfurt could be affected. However they stressed "the outcome of the referendum would not be a condition of the potential merger".

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