



2011 Annual Stockbrokers Conference
In retrospect – the ASX / SGX merger
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Dealing with a transaction which dominated my life for a significant period led me to ponder that not many of us have the opportunity to view our lives (let alone a transaction), seek to justify and explain them, and even comment on how they could have been done better.

No one to my knowledge has been given that opportunity after their life was over! So I am very grateful to have this opportunity, which I probably won't have in respect of my own life, to provide some reflections on the proposal to merge the Australian Securities Exchange with the Singapore Exchange.

Many have asked questions about this transaction and the opportunity today, perhaps, allows me to ask myself these questions and answer them. Thus providing, as one might in respect of one's own life, some insight into what motivated the ASX Board and why we did what we did.

So,

Why did we want to merge in the first place?

The answer is that there were many reasons. We understand that the business we are in requires scale, the ability to sustain technology expenses of large proportions and the need to provide product and service diversification. These requirements are not particular to us, they are global trends which in our view are set to accelerate.

More particularly –

First, we contemplated as a principal benefit of merging becoming a larger player of more regional relevance in the world, with the ability to keep at the forefront of global changes and technology generally.

Second, we were conscious that a merger could expand our footprint globally, allowing our excellent staff to expand their horizons and to feel that ASX was a place to be if one wanted to perform at the forefront of the industry globally.

Third, we believed that a merger could expand the range of products and services which we could offer to Australian investors. We felt that a merger would allow Australian farmers and manufacturers, for example, to have a wider array of financial tools for their commodity and currency risk management needs. We also believed that a merger on a cross-border basis would increase the visibility within the global investment community of Australian companies and give them, ultimately, access to cheaper capital from a deeper pool of liquidity.

Fourth, as we enter into a competitive environment in our industry we were acutely aware that our immediate competitors are (in the case of the first one, Chi-X) owned and directed from overseas. The benefits of a broad international palette would therefore be potentially available to them and, we hoped, for us too to compete. We believed a merger would give us the extra capabilities that would come from marrying overseas' know-how and having access to more of the world. This would, in our view, help entities and concerns wishing to raise capital or be involved in the markets here in Australia.

Finally, our present CEO Rob Elstone was prescient in foreseeing a spate of world exchange mergers that would change the landscape of how we operate and compete. Might I say he saw this development well before the recent crop of merger announcements.

For the reasons I mention later in respect of our own share price, we wanted to find a way of merging to make us even more relevant than we are on our own in the way we believe the world will move in our industry.

I should as an aside say that as someone who was very involved in advising on the regulation of television and broadcasting over a lengthy period, it is amusing to me to think back to the '80s (pre internet, dvds, etc) when people thought that only Australians could own commercial television in this country. How the landscape has changed since then and how just a few saw it all coming.

Why Singapore?

Let me start with a negative. It was not, I assure you, and contrary to one commentator's assertion, that we chose Singapore in order to cement my links with the "heavies" in Singapore. It is sad that anyone would think that would motivate me or indeed be of any relevance to those in Singapore.

The fact is we see and saw Singapore as a company in a country that could give direct exposure to us to Asia. You only have to go and do business there to see the immediacy of their involvement in Asia and China in particular.

We saw Singapore's model as complementary to ours and their regulatory, legal and technological arrangements to be of a high standard and to be aligned with our own high standards.

We felt from our due diligence that their management team could integrate well with ours and that their Chief Executive Officer thought as we think.

You could also say that their offer represented a deal which we were compelled to put to our shareholders. Our share price was around \$29 in the period before the announcement and Singapore offered us shares and cash worth \$48 at the time of the announcement.

It is true that they have a more modest listings business than we do. But they are not about to have competition in their home country, their business growth is extremely strong, and they are well positioned both geographically and technologically to not only knock on Asia's door but to walk in and prosper.

Why was it structured as a takeover of us and not a takeover of them?

Let me firstly say that a takeover - although it has emotive connotations - is just a structural way of two companies coming together. It is the end result that has to be studied to determine whether it is the right way to do things or not. To focus on the means of getting there if the result is good is a mistake, provided of course that it is legal and deals well with all the stakeholders.

Anyone who has been involved in mergers and acquisitions, as I have, knows that if the price-to-earnings ratio and the premium payable on your stock as it trades at the time the deal is announced is less than the target, you either can't do the deal or you should persuade the target to take you over. This is simply because to achieve the deal a premium has to be paid by the so-called offeror.

Our stock, because of the concerns about the impact of competition for market services, had dropped considerably.

Our shareholders were to receive under the merger a 36% equity stake in the resulting company plus \$22 per share in cash. This valued our shares at \$48 - approximately a 60% premium to the pre-bid price.

If ASX had made an offer for SGX and given the traditional premium of, say 30%, the swing would have been that effectively our shareholders would have had the same percentage in the merged company, or perhaps less, and no cash. The difference to our shareholders, predominately Australians, was \$3 to \$3.5 billion.

We accept that the board structure initially announced reflected the premium paid to our shareholders. Having four out of 15 directors and the deputy chairmanship was seen by many as not adequate to protect Australian interests. This is why it was later changed to five out of 13, giving us the same number of Australian residents as Singaporeans on the board, with two further non-residents of Singapore as non-executive directors and the CEO (who was not a Singaporean national).

A lot has been said about the presence of the Singapore government in the structure that we were proposing. I have to say I don't understand this.

The Singapore exchange is owned 23% by a fund for education in Singapore (as an aside I wish we had such a fund here!). Commentators kept saying that this fund, which does not under the terms of its enactment vote its shares, was a controlling stake by the Singapore government or those close to it.

Not many seem to realise that this stake of 23% in the pre-merged entity would have been less than 15% of the merged company because of the issue of the stock to our shareholders. Not many seem to reflect on the fact that the holding would be non-voting in the proposal and that that meant ASX shareholders would actually have 43% of the shares to be voted. This 43%, by the way, would on some calculations be much bigger than the number of shares held by Singapore-based shareholders.

I continue to believe that the only control that the Singapore government would have had over the combined entity is exactly the same control that ASIC and the Reserve Bank would seek to have over us.

What of the criticism?

Well as all of you know there were many criticisms of the deal.

I should note, for the record, that there were very few from our shareholders. Some constructively observed that as the deal was proposed they would be losing franking credits from their future dividends. This led to some advocating a dual-listed concept which we looked at but felt would be very difficult to implement given the regulatory and other constraints in which we were operating.

There were also a small number of shareholders who wanted more shares and less cash. We noted that they could have used the cash component to buy more shares but they were hoping that they could achieve rollover relief for taxation purposes, which of course our transaction didn't give them.

The principal criticisms came from those who believed that it would destroy Australia's chances of being an international financial hub.

I am sure that every one of my directors fervently believed, as I did, that Australia should be a financial hub in this part of the world.

The argument was put that Singapore would attract the financial hub activity and not much of it would remain here in Australia.

We did not see it that way. With so much of the capital of the merged company owned by Australian shareholders; with a large board contingent from Australia; and also, with capital commitments within the

deal made to preserve the Australian company as a major part of the merger, we believed that rather than diminishing the idea of a hub in Australia the merger would enhance it.

In essence, we had a belief that people love living in Australia and they will do so if business opportunities are here. Therefore, if as we believed the merger provided a foundation for a bigger participation in the world market from Australia by deduction those involved in finance would choose to remain here.

A number of critics have specifically argued that over time the action would move to the parent company (ie in Singapore). We did not believe this based on the strength and importance in the merger of our existing staff, and the commitment and structure of the deal.

There was a further argument that in a world of exchange consolidations we would be prevented from consolidating with the larger northern hemisphere players if we first merged with Singapore. This was based on a belief that the Singaporeans would not let the merger process continue and would seek to ensure that the group remained in Singapore. Whether the Singaporeans would or would not is obviously a question for them, not for me. However, in my dealings with Singapore I have found them to be pragmatic business people and I don't believe that the merger would have prevented further mergers later on. Indeed, I note that if there was concern on this aspect the deal could have been structured so as to ensure that further mergers were not prevented.

I find it funny that so many felt I was close to Singapore and yet those same people felt they had better judgement on how Singapore would act than me.

There were concerns about the regulation of the exchange itself. It was argued that under Singapore ownership there could not be regulation by Australians in respect of the Australian exchanges. Our view was that the maintenance of a separate company in Australia with the requisite operating licences under it, with a board majority dominated by Australians and with promises of capital expenditure not to be reduced, were sufficient to ensure that the authorities here had ongoing Australian Corporate Law regulation of the Australian licences.

What were some learnings?

First and foremost, I and others underestimated the poor general understanding in Australia of what a securities exchange is and how it operates. I can assure you that external perceptions of simplicity of operation (or worse still, comparison with a utility) are quite wrong.

Only now do I notice that when the television news talks about the exchange they show a picture of a trading floor usually in New York. As all of you know we don't have a trading floor – and haven't for decades - and indeed our business is more a technology-based one. I should have realised that this was a problem because I do admit that each month, without fail, I get a call from someone asking if I could arrange for an international visitor to tour the trading floor of our exchange (some even ask if they could ring the bell!).

This misunderstanding affects the hub argument. People who believe that there is a floor with traders on it dressed in colourful jackets also believe that you can build a thriving metropolis of traders next to the exchange. Now, I accept that for latency or speed of execution reasons some may like to house hardware and software near ours, but the concept of a physical, geographic base to a securities exchange is outdated.

Very few understood what competition meant in our industry. Even today I'm not sure how many actually know the benefits of competition – or its risks. Our listed companies are understandably preoccupied with competition in their own sectors and investors are preoccupied with investment decision-making.

There was a clear concern in some people's minds that, as mentioned previously, the Singapore government was involved and would control the future of our exchange. I have no doubt this was incorrect but it was a failing on our part not to adequately explain and correct it.

We saw the benefits (most of which I've articulated above) and we saw them clearly. I am not sure that they were clearly enough identified and articulated to generate deep and broad support throughout the business community. Sometimes when *you* think something is obvious it is a mistake to assume that others share your view.

Where to from here?

I want to place on record that I and my board are not "whingers".

I was surprised by the FIRB outcome but I accept its decision.

The Treasurer said he would follow a proper procedure and he did. He has made it clear that his view was that the benefits did not outweigh the detriments in the particular proposal we were putting up. He has also pointed out that a merger of ASX Group with another exchange is not ruled out down the track.

Concerns were raised about the power of Australia's regulators when a question of solvency arises, to ensure that clearing and settlement operations are appropriately functioning when the company controlling those operations is foreign, this issue will no doubt be considered and ASX will contribute to any relevant working group.

In the meantime, we must not lose sight of the fact that we have an excellent business and, indeed, an excellent team running it.

We have put into top gear our search for a new CEO following Rob Elstone's decision (which preceded the merger) to leave after 11 years as an exchange CEO. We already are excited by some of the candidate names who have been placed on the list for our consideration.

We have not been idle and have prepared as best we can for competition, and we aim to be a good and strong competitor.

We are fully aware of our position in the market place and of the obligations upon us as the major exchange in this geographic region.

We will look to opportunities, therefore, to improve our business and to expand it. The building of our new data centre and the opportunities that come with it are an example of just that.

The merger was an opportunity. It was in our view good for our shareholders; good for those who invest in other geographies; good for the funds managers and those charged with investing the nation's funds; good for those who seek capital from this area; and good for our employees.

But it was not to be. What is left in the short-term is a strong company, which will shortly appoint its next CEO who will inherit a company which is in great shape and has been prepared very well for a much more complex regulatory and operating environment.

In the longer term, I believe international alliances and, potentially, mergers will be the future. Perhaps before that occurs – more will understand what we do; more will understand the benefit of a world view; and the safeguards required by those entrusted with regulating us will be in place. Then, any future alliance or merger will deliver the benefits we believe in and the acclamation we would hope for in the national interest.

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