Edited Transcript of ASX Half-Year 2013 Analyst Briefing

21 February 2013

Good morning. I welcome everyone here in our auditorium in Sydney as well as people who are joining us by phone via our webcast. My name is Elmer Funke, I am the Chief Executive of ASX. I am joined here by my colleagues Peter Hiom our Deputy CEO and Ramy Aziz our Chief Financial Officer. We will follow the usual format. I will present for about 30 minutes after which we will take questions.

Let me start by giving you an overview of the results. Our statutory net profit after tax was $171m - that was down 2.5%. Now you may recall that in that last year we had a couple of significant items that impacted on the difference between underlying and statutory results so again we would like to focus on the underlying earnings which were also $171m but they were down 5.3%. Dividend of 87.9¢ and that is consistent with our practice of paying out 90% of underlying earnings as dividends.

Now as we dive into the result we see that revenues were down 3.3%, entirely driven by continued weakness in equity market activity. Activity in cash equities in fact continued to be at a cyclical low during the half. There was also a significant difference in the revenue performance by quarter, and later on I will come back to the differences between the first quarter and the second quarter and what drove that. Expenses continued to be well controlled, up 1.3%, and in the first half we had a number of important developments in the Australian regulatory environment around cash equities and we would say that we are now facing a somewhat more stable regulatory environment in cash equities for the next couple of years.

Capital expenditure was $15.4m with an increasing focus on investment in post-trade services; clearing, collateral management, offering new services to our clients. And our balance sheet continues to be in a very strong position making us very comfortable with those investments.

The next page shows the result in a traditional format. There are two analyses on this page; on the left hand side you see the traditional comparison to the prior comparable period, so first half of 2013 to first half 2012, and if you scan down the percentage column you can see underlying profit down 5.3% as I said earlier. But we also thought it was useful to compare to the immediate prior half on the right hand side of this page which was the second half of 2012. The reason we do that is because the first half of the previous year had a slightly unusual first quarter, whereas the second half of 2012 had a more stable environment so we thought it was useful to compare it to that as well. What you can see is, compared to the immediate prior half, revenues are up 3.2% and underlying net profit is up 3.4%.
When we compare the year-on-year movement in the traditional waterfall chart you can see that revenues went from $315m to about $305m and if we look from left to right across the chart, we can see

there was a little bit of life in our listings business after a couple of tough halves with revenues up 7.3%, driven largely by secondary capital raisings. And the next two red bars are all driven by continued weakness in cash equities trading. Cash market revenue is down 18%, information services which are directly linked to that are down 12%. Technical services continue to show good growth, up almost 9%, as does Austraclear up 7.5%. Derivatives was down slightly for the half but as I will explain later, this was heavily impacted by a big difference between the first and the second quarter, so the half is just an outcome of those two very different quarters and we will talk a little more about that later on. That quarter-by-quarter performance is quite relevant in the first half and we thought therefore it was useful just to highlight revenue performance for the first and second quarter.

As you can see on the next page, operating revenue in the first quarter was in fact down 8.8% on the first quarter of the previous year. Now you may recall that 18 months ago, in the first quarter of the 2012 financial year, there was a period of very high volatility which led to very high trading volumes. In fact, almost record volumes in cash equities and derivatives. Therefore a year later in a much more stable and quiet environment, you of course get lower volumes and lower revenues, and you can see that cash market revenue was down 25% this year on the first quarter and even derivatives revenue was down 9.4% in the first quarter driven largely by the strength of the year before. If we dial forward to the second quarter, which is on the right hand side of the page, you can see that revenues are up 2.8% and, in fact, other than cash equities and information services, all our businesses grew revenues in the second quarter and our cash equities businesses went down less than before but still down.

We tend to compare the changes to our revenue mix in light of the significant changes in both our investments as well as the regulatory environment and trading activity. We tend to show you a pie chart where we compare the revenue mix a year ago to the revenue mix today. Over a one-year period, those percentages change relatively little so what we thought we would do this time is take a slightly longer period. What you can see on page 7 is in fact a comparison in our revenue mix three years ago on the left and our revenue mix today on the right. There are a lot of numbers on this page so we put a helpful box at the bottom of the page to give you some insight into what this page tells us. If you go to the bottom of that page and look at the box you can see that over the last three years the contribution from cash equities, what we call cash markets, has gone down by 7%. It used to be 25% of our business, today its 18% of our business. The same is true for information services, down 2%.

On the other side we have seen good growth in derivatives and technical services. Derivatives used to be 24% of our business, today it is 31%, and technical services is showing growth and is now 8% of our business. You can see how our business mix is changing as a result of the way we invest as well as trading behaviour and our reliance on the cash equities market is going down.

This page also illustrates the impact of regulatory change on our business and that is largely in the cash equities business. If you go to the right-hand side of this page to the bottom right you can see cash market trading contributed 5% to our revenues in the first half. This is where we see an impact from Chi-X coming into the marketplace. This is where the whole debate about high frequency trading and dark pools takes place - 5% of our revenues. Then if you go slightly down you see cash market clearing and cash market settlement. Those are the businesses that were subject to the recent review by the Government and the Council of Financial Regulators into competition and market structure. You will

have seen the announcement by the Treasurer to keep the current market structure for at least the next two years and that's 13% of our business. So all the regulatory noise and impact is in that 18%.

In the first half we have seen a number of important regulatory developments and we thought it was useful to take a moment just to summarise where we are and why we are saying that the Australian financial markets can look forward to a somewhat more stable regulatory environment. We think this is the right thing for Australia's financial markets. On the left is a summary of what happened in cash market trading, so this is 5% of our business.

The market structure for that business changed back in October 2011 when Chi-X opened for business. There is another important change to come in March when best execution rules come into force for the broking community. We have seen over the last 12-months significant concerns from investors, as well as corporations, around market quality. Back in November, Minister Shorten announced a number of helpful and sensible reforms in relation to both dark execution and high frequency trading. Those reviews aren't complete and there is a continued taskforce in place at ASIC that looks at further controls around those two. We said in our submissions that it is essential that while we can implement tighter controls, and we think there are some things that we might be able to do, it is really important that we don't take a backward step because there are some things in the Australian market that are really working and that is in particular, the current tick sizes that are in place. We think they should be retained as well as ASIC allocating out its supervision costs to all the participants. It does that in both trades and orders and that has done a lot to reduce order proliferation in the Australian market. These two things are important drivers about why Australia is in a much better position than either the European or the US markets, and we think there is a strong case to keep them in place and at the margin do a few extra things. This has been well managed by the Australian regulators recognising that we have created a competitive environment.

On clearing and settlement you will be aware of the announcement the Treasurer made on 11 February to retain the current market structure for cash equities clearing and settlement but also recognising that with that comes a real obligation on the ASX to work actively with its stakeholders to manage that environment. We have been asked over the next six months to put in place a code of practice working with both regulators and our stakeholders and we will do that and we will take it seriously. But it's a recognition that the market structure we have in place is a good market structure for the Australian environment and ASX is making very significant investments to continue to build out that infrastructure.

Now I would like to briefly comment on each of our main businesses. The first is listings and issuer services. Revenues were almost $74m - up 7%. That's a pleasing result from that business. As you know it had a couple of tough halves. Both listings revenue was up, as was our issuer services revenue. The growth in this business has come from secondary capital raisings - they were up 3.6%. IPO activity continues to be very sluggish but it's the secondary capital raisings that keep up the revenues in this business. We consider this is an important front door to Australia's capital markets and to our company, and we continue to invest in initiatives that will make us as competitive as we can be as a capital market compared to others around the world.

In the first half we made an important change, with support from ASIC, to the ability of small and mid-cap companies to raise capital. We raised the maximum amount of capital they can raise without shareholder approval up 15 to 25%, provided they use the AGM to get support for that. It was very pleasing that almost 600 small to mid-cap companies used that rule change in the first AGM season. You can see how with a good working relationship with regulators, and with a sensible change that's inexpensive to implement, we can make a real difference.

The other highlight here is Australian Government bonds, a little bit down the page. We were working on that for some time and we are very optimistic that at long last, in the next month or two, we will be able to start quoting Australian Government bonds on the exchange. We are ready to do so but we are waiting for the final t's to be crossed and i's to be dotted so we can launch that very soon.

And then finally we have launched an initiative with some 60 partners from both retail distribution and the funds management industry on a new managed funds service that will essentially automate the process by which people apply for and redeem managed funds, which as you know is a tortuous process in Australia today. That is going a lot slower than we would like and we are working very closely with ASIC to see if we can find a way through that and of course ASIC will be genuinely concerned about making sure that investors continue to be well protected as we start automating a process that has been manual for such a long period of time. We are continuing to work it through and we are very determined to deliver that to the market.

The second business to focus on is cash markets, so this is cash equities, trading, clearing and settlement. As we said earlier we continue to be at cyclical lows in activity levels here so revenues were down 18% and that is despite the index being up 12.8% over that six month period. So the improvement in the index has not yet led to an improvement in market activity.

Now our value traded was down 24.5%. Revenues down 18%, value down 24.5%. And I know people are always very interested to know how much of that is the market, how much of that is Chi-X and competition, so we thought we would spell that out. If we take the 24% reduction traded on ASX, about 20% of that is just activity being down generally and about 4% is Chi-X and other minor things to do with crossings and so forth. But most of this is the impact of the market. We continue to invest to make sure that we deliver to our end clients - fund managers and retail investors - services they value and make sure that we are competitive. We have invested very significantly in a product called Centre Point which in the first half was almost 10% of our equities trading revenue. It is a very attractive product and it is very popular. Our market share was 96.5% during the half but of course that is an average number. If we look at market share today Chi-X is probably sitting in the 6-7% range of on-market trading and that is the only relevant way to look at life. As to the 96.5%, this will naturally drive down during the second half as you would expect as a new competitor continues to grow market share. We have talked about the regulation of dark pools and I think Australia is in a good position and of course we spoke about the environment in cash market clearing.

During the half we have also announced an important new revenue sharing arrangement with our clients where from 1 January this year we will be sharing the revenue growth in cash equities trading, clearing and settlement with our clients 50/50 for the next 18 months and potentially beyond. That is about

aligning our interests with our clients to make sure we collectively try to grow that business following a very difficult period during the GFC. But this is the business that has been driving the fall in revenues in full.

The decline in equity market activity has also impacted our data services business and information services revenues were about $30m, that was down close to 12%. Again this was a direct consequence of reduced retail activity but also reduced professional activity as brokers and investment banks reduce staffing levels and basically turn off terminals that consume information and trade.

On the other hand, our technical services business has been growing very strongly again. It has now been 12 months since we have opened our new data centre, revenue is up again 8.8% in the first half with good growth in liquidity access, community and connectivity, as well as hosting services. We now have 111 cabinets in the ALC and what is good about this is that we don't just have participants, brokers and banks in our data centre. We are also starting to see information services and other aggregator providers who service those clients joining our data centre. We are trying to create a genuine Australian liquidity centre which brings together everybody who needs to interact with each other to service the Australian financial markets. That process is going well for us.

The investments and information services are all about aligning our service to the needs of our clients recognising that speed is as important as the way data is being consumed. That data is being consumed very differently from the way it was in the past, for example much more data is being consumed by computers than by individuals. And in technical services we continue to build-out that business as well as increase sales of our services.

You would have seen an announcement on Tuesday where we said that we are going to connect our data network to the networks of other exchanges around the world which gives our clients overseas direct, convenient and high-speed access to our markets. That starts with Singapore, Chicago and London where we are making a very significant improvement in the way those clients can access the Australian marketplace if they choose to trade here. Of course that process works the other way for Australian investors as well.

Our largest business is our derivatives business. Revenue is down 2.3% for the half to $94.4m but as I said earlier that is really the outcome, the mathematical outcome, of two very different quarters. In the first quarter revenues were down 9.4% driven by an extraordinarily strong quarter the year before.

The second quarter revenues are up 6.4%. We think the second quarter is perhaps more representative than the first for that business, and if you look at the bottom chart on this page you can see that this business held up very well in the last couple of halves, certainly relative to some other businesses around the world. It's a pleasing performance despite revenues being slightly down.

We continue to invest in the business. You will have seen an announcement yesterday that the VIX index which used to be calculated daily is now available in real time. That will allow us, in the next couple of months, to launch a futures product against that index. In the next couple of months, we hope to launch a number of sectorial futures products as well.

The main focus in this business is on the development of new services for our clients in the clearing space. We have made a couple of announcements during the half about our investment in a new over-the-counter clearing service for interest rates swaps in the Australian marketplace. Before Christmas we said that we have seven domestic and international banks working with us on the next phase of development of that service. Now, none of those banks have an obligation to use the service but we are very pleased that they have made a decision that this is a service that is very important for our local market to have available in the Australian time zone and not just in places like London and Chicago. This comes on top of other investments we are making in client clearing and collateral management. It is a very important focus for us to make sure Australia continues to have a world-class service across all of its financial market activities.

The final business is Austraclear, this continues to do well, with revenues up 7.5%, average balances up 6.8% to $1.4 trillion. This continues to be a growing business. An important focus for this business is the development of our collateral management service. This is a service that allows our clients, the banks, to optimise the use of the collateral they have available in Austraclear, rather than just use cash to collateralise their financial market transactions which is a very expensive form of collateral. Austraclear collateral tends to be the most attractive form of collateral to use for that kind of activity. That's why we are starting to do this. Later on we will add CHESS so we have equities in there as well and then, ultimately, we would like to connect our collateral pools to the collateral pools of other markets who operate similar services so that our clients can optimise the use of collateral not just domestically but in fact globally.

We have joined something called the Liquidity Alliance which is a group of similar-minded exchanges around the world that would like to develop these services for their clients, and again we hope to deliver that service on Austraclear later this calendar year.

Next to the revenues that come out of our core businesses, ASX also earns interest and dividend income. When we look at interest income which is sort of half-way down the page you can see that net interest income was $21.9m flat year-on-year. Now if you dive into it, it's the outcome of two very significant movements. If you look from the top line the interest that we earned on our own cash was down 35.6% and this is a direct function of the reduction of interest rates in the Australian marketplace. Because we invest that cash very conservatively, a reduction in interest rates creates a reduction in earnings. It's largely mathematics. Off-setting that however is an improvement in earnings from the collateral balances we hold from our clients and that's up 40%, driven by two things; an increase in the amount of collateral that we hold, as well as a modest increase in the earnings rate on that margin that we were able to earn. The net effect of that is a flat result which in the current environment is a good result. Dividend income from IRESS was flat year-on-year.

Expenses continue to be well controlled with the entire investment program that we are now running. Expenses are up 1.3% for the half which is perhaps a little bit below what some of you might have been expecting and it's the reason we are going to give some guidance for the full-year. The main driver of growth in expenses for the full-year will be an increase in staffing. In the first half staff numbers went up 3.8% and that is purely driven by our investment in new products and services, and we flagged last year

that the development of OTC services, client clearing services, collateral management services, management fund services is not something that you do with the existing team which is incredibly tightly managed.

We are going to add some staff to develop those products and services and ultimately add revenues, and that is exactly what we are doing. We are providing you with guidance that the full-year expense growth is about 3.5%. That used to be 4% rather than 3.5% so we have tightened up a little bit but it won't be 1.3%. We thought we should give you some guidance on that for the full-year.

Capital expenditure was $15.4m. If you look on page 16, this is not unusual if you scan your eye across the blue bars. The red bars are our data centre investment so that's finished. It's up and running. But if you scan your eye across the blue bars, it is not unusual.

We did flag last year that we were going to run a slightly higher CAPEX investment profile for a little while as we invest in these new products and services. Our guidance for FY13 is up to $40m so $15m in the first-half, up to $25m in the second, and that is simply from acceleration and uplift in initiatives that we are developing. Previously that guidance was around $35m so there has been a marginal increase, largely driven by our desire to accelerate things where we can and deliver things to markets faster, but there is no material change there.

Our balance sheet continues to be in a very good position and we always share this slide with you to remind you of the strength of our balance sheet. On the left, our equity position and on the right, our cash position. I can always say this chart never changes. It hasn't changed again with both a very strong non-attributed capital position, as well as a very strong cash surplus position pre-dividend. This allows us to continue to run a conservative operation and at the same time invest in new products and services.

I would now like to look forward briefly and just comment on what we have seen in the first seven weeks of the second half. As always there is only so much you can read in seven weeks of activity, particularly if it includes January which is traditionally a bit of an odd, quiet month in the Australian economy but nevertheless we thought we would give you some insights from those weeks.

Firstly we have seen some stabilisation in the global economic environment. We have seen some tentative signs of genuine improvement in the US economy which seems to be taking hold, though it will be an up and down story but we think there is an improvement.

Europe of course is less volatile and its quiet in Europe right now, and I said to my management team this morning, quiet seems to me to be the new black - the 'new popular' thing in Europe. The serious structural issues of course remain and they have a long road ahead of them to work that through and it doesn't take much to stumble again. But for the time being, no news is good news, whereas Asia has continued to show relative strength.

It is interesting that the equity market activity is still showing a lag compared to that improvement in sentiment and confidence, and that is true around the world. Equity indices are well up in most markets

and in fact, if we think between July and around mid-February, the All Ordinaries was up 22% over that period - a very significant rise. It was done on relatively weak equity trading volumes and Australia is not unique. We are seeing this around the world and that suggests that while we are delighted with the improvement in sentiment and confidence, it also suggests from a volume perspective that it is still relatively fragile. We are looking for more activity coming back into the market to substantiate that level of confidence, and we haven't seen that yet despite trading activity stabilising in recent weeks.

Derivatives volumes however are holding up very well with ASX 24 volumes, which is the largest part of this, at pre-GFC levels., What we are picking up from our clients is that risk seems to be on a little bit rather than off which is a function of a slightly more stable environment. In extreme levels of volatility people back-off, moderate levels of volatility make people back-on.

We would then translate that to our volumes over the first seven weeks. Cash market average value traded per day at $3.8 billion for us. That's down 4.2% on the previous year so still down, still soft. But you may recall the first quarter was down 25%, the second quarter was down 10%, the first seven weeks was down 4% so as we start to compare, weaker volumes start to stabilise a bit. ASX 24 derivatives have daily average volume of 358,000 contracts. That's a good result, up 16.8% on the previous year.

The previous year included January which was quite weak but, as I said earlier, this business has been holding up very well for the past four halves. Capital raised is up materially in absolute dollars $2 billion. This is not that large a number of course but it tells you more about last January than it tells you about this year. It's pleasing at least that there is some life in that business as well. Those trading conditions are illustrated as we always do with a couple of charts. On the right hand side of page 19 you see the VIX continues to run relatively low which means volatility levels are relatively low still in the Australian marketplace. On the left-hand side you see daily average trading values by month, so every bar is the average trading value by month from January 2006 to January 2013.

For the first time, this is not just ASX, it is the entire market so it includes ASX, Chi-X, on-market trading as well as off-market trading. This is all the activity that we see in the Australian marketplace irrespective of the way it's being executed. What you can see is that in January it was about $4.1 billion. ASX did most of that volume but there is also some volume there for Chi-X and it also includes off-market trading that is reported to the exchanges. You can see it has been stabilising in the last 12 to 18 months. It's still a bit up and down. What we don't see is a material decline anymore over at least the last six to 12 months.

I would like to close by reminding you of the highlights of this result. Underlying net profit after tax $171m, down 5.3%. This translates directly to dividends and we are sticking with a 90% payout ratio for this half. That result is entirely driven by continued weakness in equity trading activity but there are other businesses performing reasonably well, particularly in the second quarter.

We continue to control expenses well and we are flagging with you that the investment in our new initiatives will see a bit of an uptick for this financial year when we get to the end of it, and that we are seeing some stabilisation in the regulatory environment in cash equities.

We do think it is pleasing for everyone. For the Australian marketplace, stability and investor confidence are such an important part of getting growth back into our markets.

In the meantime we are investing very significantly in post-trade services because that's where our client needs are and that's where we see the opportunity.