



Edited Transcript of ASX HY 2012 Analyst Briefing

16 February 2012

John Heagerty from Credit Suisse:

A couple of questions please. Firstly on the trends you are seeing at the moment. You have given us some overview of the trends for six weeks, but would you consider yourself more akin to the second quarter rather than the first quarter? Can we expect a fairly subdued second half? It seems to be what you are implying. If you could just confirm that please?

Elmer Funke Kupper, ASX Managing Director and CEO:

The reason we don't put an outlook statement in here is that of course we don't know. What we have seen is that January and the early start of February is probably a bit more like the second quarter than the first but these things can also turn. For us it's about continuing to invest in our business to get growth but we are dependent on that sentiment returning, so the first two weeks of February were materially stronger than January. Does that mean that that is the new world? We don't know. If you look at events that drive this, I'd say that it is more likely to be subdued than not, simply because the world is not a stable place yet and Europe will continue to stumble through for a little while longer. It's probably, for the time being, the way it looks but we don't give an outlook because we don't know and since we can't control that bit of it, it is about maintaining a strong balance sheet and investing in businesses where we can see growth like our technical services business and so forth.

John Heagerty, Credit Suisse:

Second question, I guess it's a slightly inevitable question, but the IRESS stake of 20%, any change in intentions with that stake, it's just sort of sitting there still.

Elmer Funke Kupper, ASX Managing Director and CEO:

It's sitting there at 18.7% I think it is at the moment and I am comfortable with that.

John Heagerty, Credit Suisse:

So no change in management?

Elmer Funke Kupper, ASX Managing Director and CEO:

There has been no change, that's correct.

Nigel Pittaway, Citigroup Global Markets:

A couple of questions if I can. First of all just picking up on your comment that whilst you would like to have capability to have unbundled clearing by June you think it's too early to do it, just a couple of questions on that. Firstly, presumably that means you think the likelihood of competition in clearing at the moment is relatively

remote. Secondly, I wonder if you could elaborate on the benefits and downside of actually going ahead with that unbundling.

Elmer Funke Kupper, ASX Managing Director and CEO:

Well, let me answer the first thing. I might ask Peter (Hiom) to comment on the unbundling initiative itself. Whether or not there is competition is not for us to decide so we have to run our business to the best of our ability and in the interests of our clients and staff and shareholders so that's not up to us. There are other people who make those kinds of decisions. I would say if you look at the way our clearing and settlement operations work, they work very, very well and serve the market very well, so relatively efficient. Of course there is real benefit in having a single clearing operation that allows participants to get capital efficiency and cross margining benefits, so while it's not up to me to comment on competition, the introduction of a further clearing house, if someone decides to, is not necessarily making it a lot more efficient or less expensive over time, but again that is not necessarily our concern. The fee unbundling project is actually all about recognising that in a fragmented market there are clients who might have different needs over time and if some of these segments become larger, we may have to tailor our services to those clients. That's independent of competition but I might ask Peter (Hiom) to give a few more comments.

Peter Hiom, ASX Deputy CEO:

Yes, I think the only thing I would add to that is just you asked about the risks, remembering that fee unbundling is not just about us responding to the new market structure. It's also aligning our fees more accurately with our existing customer base and I think if there is a challenge in all of that, it is the diversity of the customer base and us working through exactly how we do that to ensure that we don't disadvantage one group of customers over another as we try and align that fee structure more appropriately. It's a highly technical area of the business and pretty dense in its subject matter, but it's something which we will do carefully and probably in line with some service offerings that we bring to the market rather than just picking a date that we will just say today is the unbundling day.

Nigel Pittaway, Citigroup Global Markets:

And just one more question, just on the cost base moving forwards and obviously you have given guidance for the full year but could you make some comment on whether or not you think the organisation's cost base is actually right sized for the future?

Elmer Funke Kupper, ASX Managing Director and CEO:

I think if you look at even our margin of 78% and running an entire multi product integrated exchange with 500 people, I think the company has had an extraordinary track record of managing expenses tightly and so that means two things. I think that is good news because that discipline is there and we will maintain that discipline. If you then say well could you reduce that further I think the chances of reducing staffing levels here, given that we only have 500 and probably amongst major exchanges are the most efficient exchange in the world, I would say that is unlikely. I think you might see some rebalancing. I think there are opportunities to streamline some of our processes. A lot of it is not about costs it's about speed to market, for example in our derivatives business, so I think we are right sized and very tightly managed. I think my predecessor has done a very good job in that with the management team. I would like to maintain those disciplines but at the same time we need to make sure that

we invest in a couple of the businesses so that we can get some growth. It has to be about growth and if the revenues aren't coming then you shouldn't make the investment.

There are a lot of questions here so can we start at the top and move down.

Russell Gill, JP Morgan:

Two questions, firstly on the ASX derivatives business. It was a pretty disappointing result in the half given the volume uplift, can you give us a bit more detail in your expectations for changes in that market place? The reduction in size of 100 contracts was supposed to be very beneficial but it seems to have some unintended consequences, could you give us a bit more detail about your thoughts around that?

Elmer Funke Kupper, ASX Managing Director and CEO:

I will ask Peter (Hiom) to do that. I think any revenue growth of 17% I wouldn't necessarily call disappointing in the current environment but you might have a different judgement.

Russell Gill, JP Morgan:

So it's not ASX, this is the ETOs?

Elmer Funke Kupper, ASX Managing Director and CEO:

Yes, I think that's fair, I think the ASX derivatives business performed very, very well. ASX24, ASX derivatives, ETOs and Index options - I think we would be disappointed that we have seen an upturn in the activity but not translate it into revenues, so we need to make some changes there.

Addressing Peter Hiom: Do you want to say anything else?

Peter Hiom, ASX Deputy CEO:

The only thing, Russell (Gill), I think we would agree that we haven't obviously delivered the revenue growth we would have liked but I think we need to separate out the issue of the contract size change from the market making scheme. We did two things, we changed the contract size and we changed the market making scheme. It's the market making scheme part and how the fee structure relates to the rest of the market is the thing we need to look at.

Russell Gill, JP Morgan:

So can you give us a bit of insight in terms of that volume uplift, what related to market makers as opposed to the rest of the market?

Elmer Funke Kupper, ASX Managing Director and CEO:

Well, do we disclose the growth of the market makers?

Ramy Aziz, ASX Chief Financial Officer:

No, we don't but what's probably more appropriate Russell (Gill), is the growth in the index option way outstrips the growth in the single stock options and as you know they are priced differently so clearly there has been a tendency to trade the index more than the single stocks and that's I think a function of the environment and that's also had a significant impact on that average fee.

Russell Gill, JP Morgan:

Great, just a second question, more as a high level, medium-term thought for the ASX exchange globally. You have got a lot of initiatives there, particularly around the clearing house and collateral management cash margin and the like, so globally it's obviously capital requirements in clearing houses margin requirements from participants. What are your thought processes in terms of the current capitalisation in your clearing houses and the capital requirements of participants going forward?

Elmer Funke Kupper, ASX Managing Director and CEO:

I think our clearing house is functioning very well and is very well capitalised. I think we have no issues with that at all. I think if you look at how we worked through the MF Global matter I think that has been exceptionally well handled. Of course as risks increase, capital requirements and margin requirements increase as well, so we have seen an increase in collateral balances as activities increase and some risk profiles increased - that probably will stabilise a bit now. We will introduce cash market margining probably later this year I suspect, this calendar year. We shall increase the requirement, as what we try to do is make sure that we also improve our margining engines so that we optimise the margining for our clients so they get the maximum number of offsets and efficiency. That's why we continue to invest in them, because we recognise that they can't just be up, it's about being optimal, because that allows them to get the right return. It's also one of the arguments that we use around clearing Australian interest rate swaps so we can see real benefits, although it is a commitment to do it through an exchange and those commitments from the G20 tend to come with a cost. They tend to not give a lot of revenues, there tends to be a cost to those commitments on the regulatory side. We think we can do it very efficiently at relatively modest cost and give some of the benefits of attaching that to our existing clearing house, although of course doing all of that on exchange is unlikely to lead to a reduction in requirements because regulatory tightness creates an increase in requirements.

Then finally we have, I think it might be useful for Peter (Hiom) to briefly comment on collateral management because that's something we talk about. We have got some work underway with Clearstream to look at so that we can provide collateral management services to our clients.

Peter Hiom, ASX Deputy CEO:

I think the theme here of course is scarcity of collateral and capital amongst our customers. We have two depositaries or one sub register and one depositary in which we hold approximately \$3 trillion worth of collateral. Currently there is no service provider in Australia delivering a service that is essentially a tri-party arrangement between the service provider and two counterparties to ensure that there is the collateral required to back that transaction. That doesn't necessarily mean a transaction executed on our exchange, it could be an OTC transaction. So that collateral is the cheapest to deliver, if I could use that term, so there is a high degree of inefficiency in collateral management in Australia. We are relatively behind the eight ball compares to other markets; the service offering we are talking about is being implemented in South America with Clearstream. We are well progressed with the model as it would work with Clearstream, leveraging some of their infrastructure but delivered and operated by ASX onshore, so we should have more news towards the middle of the year on how we intend to deliver that to the market.

Anthony Hoo, Nomera Securities Ltd:

I have a question in relation to your answer earlier to Nigel (Pittaway's) question. You spoke about a cost base and also the need to invest. Could you give us a bit of insight as to whether there are any implications for CAPEX

going forward? I know you provided guidance for this year, but are there any projects in mind that could be impacted or that could increase the level of CAPEX for the next few years?

Elmer Funke Kupper, ASX Managing Director and CEO:

It's a good question. I should say we haven't quite finalised our forward plans yet, we are in the middle of doing that, having been here four months. I think it is fair to say we won't build another data centre which has really been the spike that you have seen over the last little while, so if that gives you a hint that you won't see that kind of pattern again that is probably accurate. Then, where it settles down, I think we are still trying to figure out as we try to sort of manage our forward load and so I could probably give you a better feel for that at the full year. Certainly those big \$35-\$40 million projects that we have seen like the data centre, I think that's behind us so we are settling into a slightly more normal pattern. The height of that I can't give you guidance on today but we might talk about that again at the full year.

Ross Curran, Commonwealth Bank Institutional Banking and Markets:

Just wondering if you could give us a bit more of a flavour for the low latency data product and what you expect the take up on that product to be?

Elmer Funke Kupper, ASX Managing Director and CEO:

I will pass that on to Peter (Hiom).

Peter Hiom, ASX Deputy CEO:

Well there are two flavours to that, and apologies for using the industry vernacular but I am not making this up - they are called ITCH and OUCH. The two products are around latency of trade entry, order entry and also latency of data retrieval. We expect those products to be in place for both platforms over the next 12 months and they are essential for anyone operating a low latency algorithmic trading platform. What impact that has and the take-up is I guess for us to see as that rolls out, and the pricing of that I think will be something we will be paying close attention to as we look at the change in the way that data is consumed. We have come from a world where data was really considered to be counted by the number of eyeballs looking at screens and we are now increasingly moving to a world where we are counting it by the number of platforms that consume data electronically. It's very hard for us to say exactly how that will impact at this stage but that will form part of the way we evolve our licensing structure in data generally over the next 12 to 24 months.

Ross Curran, Commonwealth Bank Institutional Banking and Markets:

In terms of data retrieval though, could you talk us through the regulatory concerns about providing data at different speeds to different uses?

Peter Hiom, ASX Deputy CEO:

I think the international experience is one that we need to look towards which is the concept of fairness of access to data comes in the form of access to data at the same price, so we will not be excluding anyone from having availability of that data. In much the same way as access to the data centre itself needs to be on a fair and non-discriminatory basis and that's I think embedded in the market integrity rules that we must deliver data in that sense. I think it's more around the availability of data to everyone who wants it and the fairness of the price, that it's the same for everyone as opposed to the issue of whether fast data versus slower data is something which is inherently unfair.

Ross Curran, Commonwealth Bank Institutional Banking and Markets:

Just not going to put the small brokers out of business who can't compete with the large brokers?

Peter Hiom, ASX Deputy CEO:

I think Elmer (Funke Kupper) said earlier it is the world that we live in and as we often stress, we didn't create the multimarket environment, we are just responding to it. Clearly across a range of areas there are some challenges for small brokers, not just in data but in terms of all the technical services that you need to compete in this environment.

Elmer Funke Kupper, ASX Managing Director and CEO:

The irony of course is that we all think we have introduced competition in the exchange role but the consequences of that are quite material for a market of our size and there are two big consequences that we might learn to regret. There are some consequences that people love; our exchange fees and product innovation but there are two consequences that we might learn to regret: the first is it might lead to a faster demise of the smaller brokers. I think they were under pressure anyway, but I think this is not assisting them to compete because the investments that you need to make to compete in this world are very material. We are making material investments and the large trading houses make their material investments, so that's one.

The second is that, smaller brokers can see a cost but not a revenue line effectively and so we think that might lead to greater consolidation. The second thing that we might learn to regret is what it does to the size of the lit market versus the dark market and we continue to argue very, very strongly with the regulators to do some things now that start to manage that better than what we have seen overseas. We think there is a role for dark markets but it can't be at the expense of the lit market being the main vehicle for capital formation because if you draw that to an extreme which is not today, tomorrow or even next year, you can get quite serious outcomes. We don't have an issue today but neither did Europe and they do have an issue today, so I think it's important that regulations are put in place early. You only have to read the back page of the paper yesterday to see our views on that and I think we have a good reason to have those views which has got nothing to do with competition. Those two things I have just mentioned have nothing to do with the competition between CHI-X and ASX, it's all about the consequences of what has been done and the market in which both CHI-X and ours operate now.

Chris Williams, UBS Securities:

I've got a couple of questions. I think in your prepared remarks you made the observation that it's probably just too early to discern the consequences of market structure change and trade market competition. I am wondering what might lead you to draw more decisive conclusions about it and claim victory or otherwise.

Elmer Funke Kupper, ASX Managing Director and CEO:

I think it's two things. It's growth in the overall market as well as the way market shares start to move in the translation of that to our revenues. I think the company decided a while ago to pre-emptively take some pain and so in that sense we have sort of taken some of the impact already and therefore we are in a more stable environment already because we have taken the pain. But until we see much more material growth in higher frequency trading and we see market shares move more material, which they very well might do, I think I will be quite disciplined and patient and not knee-jerk. If you look, for example, at a product like PureMatch right now, I am not particularly concerned whether that is in pilot or not in pilot but the day might come, the day might come soon. I think it's all about being prepared and being nimble in your responses and so what happened in October, we are still actually really in the same position as we were in October, so these things take a little bit more time to develop. Perhaps at the full year we will have a clearer picture about how those shares are faring, how customers

are behaving, how people are connecting and the trading strategies of particularly high frequency traders. Right now that is not material enough for us to change what we do and I am certainly not going to knee-jerk. We are going to be very, very patient. Ask me again at the full year.

Chris Williams, UBS Securities:

And at this stage how much of that activity or lack of activity would you attribute to the lack of an inverted pricing model, a lack of rebates for makers and takers and so on?

Elmer Funke Kupper, ASX Managing Director and CEO:

I think it is not, it might be a contributing factor but I don't think it is all that material right now. As you know we have argued very strongly again that one of the things we need to make sure of in this market is that we don't invert pricing and go down an environment where exchanges, this happened in the US where they got a relatively narrow band between maker and taker, that then went to zero. That went negative and basically you get this ever expanding difference between maker and taker pricing as exchanges do nothing but pursue activity between themselves. The only people who make money out of that are regulators because the monitoring of that is an expensive activity and, of course, some high frequency traders. We think that so far ASIC has taken a very sensible approach to this so we don't have inverted prices in Australia. We think it's very important to never have inverted prices in Australia. It doesn't mean you can't rebate down to zero if you want but inversion actually adds nothing to the market we think, so it's taken a sensible approach on that so far. We also think it's important to make sure that there are some controls around access to dark pools to make sure that the lit market remains the main lit market domestically. As a contributor, again I can't say. What we do know is maker taker pricing in Australia, relative to the core exchange prices, are relatively attractive so they should be able to make money out of that I would say.

Chris Williams, UBS Securities:

Second question, very similar to your predecessor, you have tried to avoid having any mention of overseas engagement or participation as an exchange. Historically, the words like imperative have been used by the ASX, would you use a similar term or do you just want to avoid it entirely?

Elmer Funke Kupper, ASX Managing Director and CEO:

I think that's a wonderful rhetorical question isn't it really. That really allows me to not answer it at all. Is this about exchange consolidation - is that what you are talking about?

Chris Williams, UBS Securities:

Correct.

Elmer Funke Kupper, ASX Managing Director and CEO:

I think none of them have succeeded so far for different reasons, some of them good, some of them not so good. I think attempts will continue to be made, it's a fact of life. It's a bit early for me to comment on how we might think about participating in it or not so it's better if I don't say anything at all therefore.

Chris Williams, UBS Securities:

Sure and just one point of clarity, similar to Russell (Gill's) question on risk based capital in the business. It looks like your tangible equity is in the order of 1.4 to 1.5 times your measured operational risk requirements. Do you

think about it in those sort of multiple terms or can you give investors some degree of comfort around a relative level of capital in the business so they can assess the level of surplus cash and so on?

Elmer Funke Kupper, ASX Managing Director and CEO:

I might ask Ramy (Aziz) to comment, but every half we publish a non-attributable capital position which is an important measure for us, thinking about the strength of our clearing as well as surplus cash balances and that's what we really manage. Overall, our capital position is incredibly stable which I am very comfortable with and I am not looking to change but I might ask you to comment.

Ramy Aziz, ASX Chief Financial Officer:

Yes, the surplus that you mentioned Chris in terms of capital and cash, that's pre-dividend. As you know we have just announced the dividends, so \$162 million of that will be utilised in March to pay the dividend, so we take that into account as well. The other part of the question is really around, I think, in the current environment and the number of initiatives that we have, we think it's still prudent to maintain that level of surplus. It's something that we monitor continuously so we won't just sit on it and say "oh we will be fine for a while", but really I think it's those two things at the moment.

Elmer Funke Kupper, ASX Managing Director and CEO:

What we might do now is open it up to questions via the phone to give those people a chance as well.

Thank you, we do have a few questions over the phone. The first question is from Kieren Chidgey of Deutsche Bank so please go ahead.

Kieren Chidgey, Deutsche Bank:

Good morning, I have a follow-up question on the ALC, just wondering if you could talk more broadly. I know you commented on this in relation to a question around market data potential uptake there but just hoping you could comment more broadly on the sort of take up you have seen across hardware and rack spaces and how that has compared with your expectations?

Elmer Funke Kupper, ASX Managing Director and CEO:

I might ask Peter to comment on that.

Peter Hiom, ASX Deputy CEO:

I think we are very satisfied with where we sit, I don't think we disclosed the number of racks that we take up so I will just describe it as very satisfactory and in some areas ahead of expectations. You have to think as well that the technical services business is one with many, many price points to it that not just relate to the racks but also the power, the number of connections between racks, the trading platforms, and the number of connections between the participant's racks and service providers that sit within the co-location facility. All of those are the things that we look at to try and grow and, as you would expect, some of them are ahead of schedule, some of them are behind but generally speaking overall we are very satisfied with where we sit.

Elmer Funke Kupper, ASX Managing Director and CEO:

One of the things that we will be looking at is, I think we have excellent disclosure across each of our business lines but of course around technical services there is a whole new world that we have entered and are operating

in now. We are looking at whether or not we can give some more colour next time around about some of the indicators that drive that, recognising there are many pricing points and a lot of complexity.

Kieran Chidgey, Deutsche Bank:

I was just hoping for a sense of how far you think we are along that process in terms of a take up, particularly with the futures part of that yet to open up, should we be anticipating the strong growth you have seen there this half continue into the 12 months ahead?

Peter Hiom, ASX Deputy CEO:

You are asking for me to make a forward looking statement on the revenue of the data centre. As I say we are very happy with where we sit. You are quite right in terms of the data centre move was delayed and the movement of the futures platform is scheduled to happen in the coming weeks, so we have yet to see the full effect of the co-location offering come into play for futures. That's what causes us to be satisfied with where we are and we continue to have aspirations to continue to grow that part of our business.

Richard Coles, Royal Bank of Scotland:

Just wondering if the sort of decline you are now seeing in derivatives volume is changing your thinking on the large volume rebate going forward or just how you are seeing that, some comments please.

Elmer Funke Kupper, ASX Managing Director and CEO:

I think overall it has been working hasn't it. We've seen a fall-off in the rebate as well so is there anything else to say about that, I think it has been working reasonably well for us.

Peter Hiom, ASX Deputy CEO:

Yes, we will continue to review it as we do each year and we will set that towards the end of the financial year as appropriate.

Ryan Fisher, Goldman Sachs:

Two quick follow ons to the last questions and then my real question. First of all just following on from Richard (Cole's) question on the large volume rebate, could you perhaps give us some indication Ramy (Aziz) how that was accrued at the half? Was that just based on the actual change in activity over the half or do you actually look to take a full year view and then accrue it on that basis?

Ramy Aziz, ASX Chief Financial Officer:

No, we take the actual volumes for the half year and assume that's 50% of what the year is going to be.

Ryan Fisher, Goldman Sachs:

Great thanks, that is what I was after. And going back to Kieran (Chidgey's) question and asking in a different way to try and get that forecast you didn't want to give, seriously not a forecast but a comment on. With the data centre only kicking off now-ish, could you give us some idea of how much revenue actually would have, in principle, gone into the half you have just reported or if a lot of it is loaded into this half we are in now?

Ramy Aziz, ASX Chief Financial Officer:

Oh look it wouldn't have been significant so the delay hasn't had a significant impact I think is the short answer.

Elmer Funke Kupper, ASX Managing Director and CEO:

That's a very good way to ask the same question.

Ryan Fisher, Goldman Sachs:

And something that came up in your prepared comments, I notice there is a mention in relation to listings of a pricing review and I gather that is always under review. Can you give us an indication, is that a quantum of pricing or is it about more complex pricing structures given that you are trying to be a little bit more tailored in the listings offerings?

Elmer Funke Kupper, ASX Managing Director and CEO:

We haven't made a decision about that and it could be a bit of all of it. I think one of the things you will find with me is that I think pricing is something you look at at least every year and as market conditions change we have a habit of doing it, I think every three to seven years depending on the product. I think as a commercial business this is something that is just an ongoing thing we need to do so we haven't made a decision around that. All it says, therefore, is that we are looking at it and seeing if there is a case to make some changes perhaps in structure as well as price but again no decision has been made on that.

And if there are no more questions and I look around the room in Sydney here. There is one more question.

Michael Leonard, Royal Bank of Scotland:

Quickly, I see you have mentioned in your business initiatives OTC derivative clearing. I just wanted to get an idea of what you see the revenue opportunity there as being. I understand anyway that the pricing in that market will obviously be in that product and will be a lot lower than what you charge in cash equities.

Elmer Funke Kupper, ASX Managing Director and CEO:

We won't give that, we won't give you a number, but it's not all that material I think is the reality.

I think that is where we will bring it to a close. Thank you for joining us here in Sydney and also on the phone and over the web. I hope it was useful and feel free to contact the Company and Ramy (Aziz) about any questions you might have.

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