



## Edited Transcript of ASX FY 2009 Analyst Briefing

20 August 2009

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**Victor German – Deutsche Bank**

*Just a question on costs. Given your second half costs were lower than the first half and you highlighted that there are no increases in staff expenses in 2010, is CPI a conservative guidance or are we missing something?*

**Robert Elstone, Managing Director & CEO ASX Ltd:**

Well you tell me what CPI is going to be and I will give you a really good answer I think. Whatever the CPI is going to be we will endeavour to manage the cost base below that kind of headline inflation rate. It may prove to be conservative but it is really bound up with what happens to activity levels during the year

**Victor German:**

*Can you see your costs being flat in 2010?*

**Robert Elstone:**

I wouldn't answer that in a forward looking sense; I think we have given the guidance that expects it to be within the CPI range. By definition if CPI comes down which is currently the trend we would expect to be not very much up on the year we just posted.

**Victor German:**

*And secondly what capital do you expect to be generated out of the DRP?*

**Robert Elstone:**

We don't have an expectation; I mean we have set the discount on the final dividend at a rate which we have benchmarked against other DRP's in the market. We have internal assumptions as to what we think a retention rate will be but I am not inclined to comment much further, because they could be proven to be wildly out in the next 3 or 4 weeks. I mean I think average retention ratio is somewhere, fluctuating between 10 and 30 percent. We would expect to be in that range at that level of discount, given how retail biased our register is we have set the discount at a level which we think will be attractive for this first offering.

**John Heagerty – RBS:**

*Two questions if I could. Firstly could you tell us whether you have had any conversations with ASIC recently about the potential award of new market licenses, how that's progressing, how do you see those progressing?*

**Robert Elstone:**

No conversations with ASIC is the first part of your question. We haven't had any conversations with them and how we see it progressing that, is a question for the government not for ASX. We are not part of the decision making process and John to disappoint you even if I knew I probably wouldn't share it with you anyway. The better answer is I don't know.

**John Heagerty:**

*Thanks that's fine that clears that up. Second question is related I guess, could you just tell us about the progress of your new products Centrepont and VolumeMatch, what sort of reception has been there?*

**Robert Elstone:**

Well they are not live so by definition there is no reception to give you feedback on but we are just going through the regulatory clearance process, rule changes were lodged some time ago. ASIC has

been thorough with its assessment of those prospective rule changes and as I said we are still awaiting regulatory clearance so that we can go live. But at the moment as far as the functionality being embedded in our matching engine, it is sitting there idle waiting to be turned on. We are endeavouring to ensure that our real time surveillance software can accommodate that additional functionality but it's really going to be driven, the timetable is going to be driven by ASIC and government.

**John Heagerty:**

*I was really just referring to broker reception, have you been sounding out in the market?*

**Robert Elstone:**

Oh I think brokers have been really across the four or five areas of additional functionality, all have been broadly supportive of just about every area of rule changes that we have talked about, bearing in mind some of the changes are a re-introduction of functionality that was lost in the migration from Seats to the Click XT platform. So, some of it is just a return of functionality that was lost. Some of it is new functionality designed to accommodate different trading styles but we certainly haven't had any resistance or lack of support and I think because of broker time horizons which tend to be very short they would like it yesterday if possible. So, we are simply responding to what we believe is quite a strong broker demand for it.

**Kieren Chidgey - Merrill Lynch:**

*A couple of questions if I could. The first one Rob, just hoping you could discuss the prospects or the work being done in terms of two possible initiatives, the first being bond trading for retail investors and the second being OTC derivative clearing given the offshore trends.*

**Robert Elstone:**

On the first one Kieren - bond trading. I think things are at an early stage simply because the AOFM upshot in the tender process really only got underway in February/March ahead of the federal budget. I think when the forward estimates come out of the budget process became public information it was evident to a large number of participants in the market that it would be in the long run interests of the government to widen distribution of not only plain vanilla CGS but treasury notes, index bonds, there would be wide public support. But it is, it's probably a minimum one to two year project for AOFM to ensure that not only distribution is physically built but incentive arrangements are addressed because clearly you are trying to revisit history in terms of the current bias of incentive arrangements away from fixed income securities towards equity securities. So they have got a number of avenues of challenge. I mean the financial planning industry is going to be one of them because traditionally financial planners have shown very little interest in fixed income securities and yet as I said at the half year we are probably poised for something of a renaissance or reallocation of popularity of investment activity back towards fixed income as well as energy. So I think it's probably a one to two year project from a government point of view to make sure distribution is widened and those incentive arrangements actually work in practice. Quite what is going to happen with the government's aspirations for Aussie Bonds around the NBN rollout, I think that's anybody's guess at the moment but clearly anything that can be achieved on the CGS and index bonds and treasury notes side you would think Aussie Bonds could piggyback on that infrastructure when it's in place.

From our point of view for us it's probably more like a minimum 12 months project to fully assist. It involves license variations through our settlement and depository operations, as well, the listing side of it is very, very straightforward because people can almost list them now so probably for us a 6 to 12 month project. For government probably longer - 2 to 3 years to fully expand but given that the stock of CGS is not likely to go away quickly, it's probably a good sound investment on AOFM's part to start that process now.

OTC clearing, I mean its getting an awful lot of airplay given the Geithner Obama plan and legislation that's going through the Congress in the US, I think it would be a giant leap to start extrapolating that into the Australian environment, both from a regulatory perspective and from a commercial perspective. Largely because our OTC markets are smaller, not just in absolute terms but in relative terms to exchange traded markets than in certainly in the US. The early customer feedback we have had going to John's question is probably that there is more of a customer driven demand on the equity derivatives side than there is in plain vanilla OTC clearing of say interest rate swaps. So I think given our internal resource constraints and our ability to manage projects, we are focusing probably disproportionately on seeing how we could leverage our clearing and settlement offering into the equity derivatives space first, long before we look at other alternatives like interest rate swaps. The

topic that is getting a lot of airplay in the US is CDS swap clearing. It's got virtually no application to us because there are only about 28 of 1200 names that are Australian in the market. The vast bulk of CDS swap clearing is clearly being captured by ICE in the US and prospectively ICE and EUREX in the European markets. So, for Australia that's got virtually no application because there are so few Australian names involved in that market.

**Kieren Chidgey:**

*Thanks, the second question is just a quick one from Alan on the spread margins on participant balances. Where are they tracking post 30 June and has there been any incremental addition in terms of the margin you can charge participants which will help reduce some of their reduction coming through in spreads?*

**Alan Bardwell, Chief Financial Officer, ASX Ltd:**

Yes, as I said basically in terms of the second half we were around about 20 basis points and that sort of trailed through the latter part of the second half and we are at similar kind of levels as we have moved into the early part of financial year 2010. So yes, certainly if you look at the long term sort of spread rate that we have in terms of investment management it would be around about 15 points. So you would expect it to gravitate back to that over time. We have probably just gone through a bit of a golden period really.

**Robert Elstone:**

We did widen the spread margin on the ACH side when we refinanced the Radian Insurance with a drawn debt facility and we flagged that we may do that during FY10 and if we do that we will certainly look at spread margins in a charging sense if we duplicate on the futures side what we did on the cash equity side in the year just finished.

**Steven Kent – QIC:**

*Just clarification on a comment Alan made on the SFE market rebates. Alan commented that once the level of volumes are greater than 15% [that's when the 75% rebate kicks in], is it on volume or is it on revenue?*

**Alan Bardwell:**

Well basically the starting point is volume but, then what we will do is convert this into a revenue equivalent by taking an average fee and apply it to the volumes to come up with a revenue base that the rebates are then calculated on.

**Steven Kent:**

*So it's like with the cash equities rebate structure?*

**Alan Bardwell:**

Yes it is. The cash equities is basically where the gross revenue is the starting point whereas obviously in the derivatives we just start off by computing the volumes and converting it into a revenue amount. Yes but they are pretty much the same principal.

**Russell Gill - JP Morgan:**

*Two quick questions. First on the CAEX front; CAPEX has ramped up over the last year, or not ramped up, it's gone up in the last couple of years, you have signalled a couple of projects on that front. Should we see this as a hump or more of a base from here on in?*

**Robert Elstone:**

In terms of CAPEX, I think we have definitely moved into a period over the last couple of years when we had to invest in capacity, we had to invest in supervision, risk management and we will take another look at it as we get to the end of financial year 2010 and see what kind of pipeline we have got. But certainly moving into the next year yes, we are easily going to see 25 to 30 and we will review it in about a years' time and see where we are.

**Russell Gill:**

*And just on VolumeMatch coming back to that point before, Singapore Exchange has recently entered a dark pool JV with Chi-X. I was wondering Rob, your thoughts on that and whether ASX would look at something similar.*

**Robert Elstone:**

VolumeMatch I guess is something similar in a product sense because it will be badged a dark pool. We would argue that VolumeMatch is quite different from all the other dark pools out there, not because it is more virtuous, but I think in the sense that our own VolumeMatch facility will get its reference price from the bid offer spread in the CLOB. So, by definition the post trade transparency, everyone will know the price at which transactions are going through our own dark pool, as and when it becomes operative. Look I don't have much to comment on in terms of that JV until further notice. It is a bit of a departure for Chi-X who up until now have stated claim that they are more aligned with the sort of light market proponent but I guess they have got their own business to run and they have made this particular move through Singapore. It doesn't particularly surprise me that it is Singapore given the business profile of Singapore. It doesn't surprise me, does it trouble me, not particularly. I think there is going to be a raft of, there have been a raft of these dark pools springing up in brokerland. Liquidnet has continued to be successful. In the fullness of time we will have our own dark pool albeit one that is quite different to everybody else's because that reference price will really be a Siamese twin to our own CLOB but I think it is just too early days Russell. I would love to say more but you know I think it will sell a lot of newspapers, it will create a lot of research for the sell side but commercially whether it will be a raving success I think you probably ask me that in 12 months time. I don't have any particular insight on whether it will be.

If there are no other questions in the room then I will open it up to people that may be on the telephone line.

**Deana Mitchell – Macquarie:**

*I have a couple of questions. Firstly just in terms of other revenue declining 30% the first half and the comments in there that's relating to delayed settlement. I am just wondering whether you expect further improvements in terms of delayed settlement or whether you see that the second half 09 as a kind of a base going forward.*

**Robert Elstone:**

The failure rate Deanna, this will sound counter-intuitive because of the choice of words but the failure rate which is what drives the fail fee, is getting down to all time record lows and to world's best practice. So you know it's really asking us how much will we approach the mathematical limit where we won't ever see any T+ 3 settlement failures. It's continued to improve in a trend sense as your question points out and it has been influenced I think by the fact that in March we introduced a T+ 5 automatic closeout requirement and that's further assisted it. It's a classic trade-off between on the one hand a loss of revenue to us but it's revenue we would rather not get quite frankly because we would far prefer to have the risk reduction coming through the settlement profile but, whether it proves to have bottomed out is anybody's guess. My intuition Deanna is that it is approaching a sort of more normal flat level but I just reiterate it's very, very close to best practice at the moment and certainly substantively improved on what we already thought. I think a year and a half ago we were about the third ranking equities exchange in terms of that clearance performance and we must be knocking on the door of being the number one performer at the moment.

**Deana Mitchell:**

*OK thank you. And my second question is just with regards to the bond market initiative. Can you point to some successful countries or where you would aspire to mirror in terms of that initiative?*

**Robert Elstone:**

Well Australia generally has really lagged because of its fiscal probity and its zero net debt position. Australia really hasn't had a government investing in its own bond market. I mean when Peter Costello did the bond market review back in 2002 he was thinking about killing his entire domestic bond market, a decision that 6 years on doesn't look as if it would have been a very good policy decision. So historically this is really not much of a question for ASX. I think it is more a national interest issue. Most of the other OECD countries have had for a much longer period of time because they have either been running deficits for longer or they have been investing in the actual infrastructure supporting their own bond markets. They are way ahead of Australia in terms of having very well developed wholesale and retail distribution that supports distribution of government securities, so we have as a nation, a long way to go. Having said that it's not a very high mountain to climb if you set out climbing it save and except probably for the incentive arrangements I have talked about earlier. So I have given a sense I think in my earlier response, it's probably a 2 to 3 year initiative for the government, a shorter time frame for us to be prepared for it but we are lagging. So if you look at the UK, Germany and the US as the standout markets, they all have very large bond markets, they have all been running deficits

for substantial periods of time if you look over long decade time periods and they distribute their securities not only through wholesale mechanisms but through the full range of retail mechanisms. So there is something the government can learn here and copy quite easily as long as we can overcome the challenge that we have a large financial planning industry that's culturally and incentive wise, very biased towards equity markets and that is going to be reconcilable over coming years with the fact that I don't think equities are going to go backwards but I think fixed income and energy as asset classes are going to emerge. And that's going to be a challenge for the financial planning industry generally, to change its game in terms of participation in distribution of not just equity products but those other asset classes.

**Deana Mitchell:**

*And one more question if you don't mind in regards to fee increases. You have put through some fee increases across various parts of your business and I think I saw an options one last week where you said you hadn't increased prices for the past 15 years. Just wondering in terms of looking forward whether you plan to increase prices, what your philosophy would be there on the price side.*

**Robert Elstone:**

I think the general philosophy, the one you are alluding to (a) there hadn't been a change for 15 years and (b) its revenue impact is miniscule across the entire company. Pricing philosophy generally, I think depends which part of the value chain you are looking at. Clearly we feel that the gain sharing arrangements which are embedded in our rebate methodology are fair in both directions in the sense that the 75% gain share is biased towards market users in a growth market and yet shareholders are hedged on the downside. We have ameliorated or we have modified our annual listing fees which we hadn't done for 3 years and we have obviously fine tuned our secondary capital raising fees in the wake of the fact that the secondary capital offerings last year were biased by jumbo placements. But beyond that I am not expecting we will do any or certainly many price changes in the current financial year 2010 beyond what we have already done.

**Mike Younger – Citi:**

*A couple of questions with respect to all the government bond issuance we have seen. Rob, firstly what is your opinion of the reason why SFE volumes since all the additional CGS have come on strength haven't risen in proportion?*

**Robert Elstone:**

Probably Mike I think the answer is that the time period your question is alluding to is probably just too short and therefore too soon to tell for me to give you a good answer. If you look at the subscription rates on the tenders that have been running at 2 a week in the order of anywhere from 1 to 1½ billion on issue per week since February, there is a correlation between futures volumes particularly in the 3 year contract and the fact that it's been largely shorter dated bonds that have been issued. But I just think the time period is too short to give you a better answer than that. Also over different time periods what impacts the 3 year has as much to do with spread relativities to other markets as it does a direct correlation between physical issuance and usage of the contract. I mean we have had a number of moving parts in the last six months. The banks, offshore funding flowing through to the swap market, that's another key driver of utilisation of SFE derivatives. So I think you probably need at least 12 to 18 months of data to start really seeing the kind of correlation that your question implies.

**Mike Younger:**

*OK and my second question is in respect to Austraclear and what kind of benefit you would expect to see there in the fiscal 10 year as a result of all this. Can you give us a feel for magnitude, are we talking 25%, 50% maybe even doubling its contribution?*

**Robert Elstone:**

Well I think Austraclear given the charging regime has got as much to do with holdings balances as it has cash transfer activity. Cash transfer activity has been remarkably stable over a long period of time. So, really your question is code for how much do I think the fixed income market is going to grow by over the next 2, 3, 5, 7, 10 years. I think it is going to grow an awful lot faster than it has through the rear view mirror because we have had such fiscal probity coming out of the government and a pretty lacklustre corporate bond market so that the mix of the fixed income market is already beginning to change because through the rear view mirror it was dominated by mortgage securitisation. That's obviously taken a bath in the last 2 years care of the GFC. All the early signs are that I think with the spreads beginning to appeal to the fixed income investments because of low nominal rates and an awful lot of thinking and conceptualisation activity going into what do we need to do with incentive

arrangements to stimulate the re-emergence of a corporate bond market. We know the government is going to be a big issuer and semis will be a big issuer as part of the infrastructure push embedded in the fiscal stimulus that have been announced by government in the last year alone. But the 64 thousand dollar question is really what alterations to the incentive arrangements, what could come out of the Henry review at the end of the year that could really stimulate an on-shore bond market. So short of saying I think the growth prospects for AstraClear Holdings are probably brighter than they have ever been before but embedded in that response is how big the displacement effect will be between the loss of mortgage securitisation versus a growth in government and semi-government issuance plus potentially a re-emergence of a corporate bond market. That's hard to guess and I certainly wouldn't guess any longer than a 1 or 2 year period. But we would expect the kind of uplift we have seen in AstraClear in the last year which was 80 odd billion to become a reasonably reliable annual number for the next year or two, purely based on the AOFM estimates of CGS and the kind of multiplier activity that will be spun off that by corporates crowded out from bank credit markets naturally turning to securitised forms of borrowing activity.

**Mike Younger:**

*One final question, if I may on the dividend payout of 90%. Do you think longer term that this is the right number for ASX?*

Good question. We look at that all the time and it will continue to get scrutiny. I think certainly, going back to an earlier analyst question, once we get some insight into the DRP retention ratio, and we get some clarity around any changes in regulatory requirements for regulatory capital, it will really be those two data points that will influence our thinking about whether 90% stays a desirable sustainable payout ratio or whether we reduce it. We are most unlikely to increase it because it is already high at 90 but we will be looking at that carefully in the current financial year or realistically Alan will be and then I will look at his thinking and we will share both of our thinking with the Board during the current financial year. We didn't see any reason to depart from it in this final dividend declaration given we were introducing a DRP.

**Ryan Fisher - Goldman Sachs:**

*Thanks, they were exactly the same questions as Mike's so you can scratch me from the list.*

**Robert Elstone:**

Thanks Ryan a terrific question. Mindful it is 25 to 1. Thanks ever so much for attending and a good set of questions.