



ASX Analyst HY Q & A 18 FEBRUARY 2010

John Heagerty, RBS:

Just a couple of questions, firstly on the speed of the new products you are bringing through. I know its always very difficult to mention specific metrics and you are quite worried about that when comparing with potential competitors but could you say anything, relative 2 times or 3 times faster speed you are having to bring through there compared to what you have got at the moment on the ASX trade site.

Robert Elstone:

I am not a technologist or an engineer so I am dangerous in this space John but I think we will be making an announcement a little bit later today which will provide you with some of those metrics and the only reason its later today is it won't be an announcement from ASX, it will be an announcement from NASDAQ OMX, the actual vendor of the application so I will not make a fool of myself in the technology space but it is substantially faster and truly world class in latency performance but I think you will just have to wait until after the close of the market today to see those actual operating metrics as far as the new platform is concerned.

John Heagerty:

Just a second question on the cash collateral balances, is there any way we could attempt to forecast that at all, it seems to move up and down sort of according to the whims of the market but is there any way you look at it differently.

Robert Elstone:

They are driven by 60 day moving average implied volatility so if, without sounding sarcastic John, if you can tell me what that is going to be I will tell you the answer to your question. We have no idea and we don't bother to forecast I think Alan's comparatives told you that at the peak of the crisis we were carrying I think peak margin levels of about eight to eight and a half billion and you can see with the substantive reduction in volatility they have come down to the sort of high two's so there is an enormous span. We don't bother forecasting them because forecasting volatility for us and I suspect for most of your firms is a negative sum game but the technique we deploy is a globally proven technique used by most of the world's clearing houses and that is a 60 day implied volatility so if you were to track that yourself as an analyst it would probably at best give you an indication of when we were likely to reset margin levels but it wouldn't tell you what that would translate into in terms of gross margins that we would carry because that would be a function of what was happening in terms of the opening and closing of open positions in the derivative market so sorry I can't be more helpful. All I can tell you is how we do it but we don't do it in a way that is used as a forecasting tool, we actually do it as a way of calling margin day to day.

Andrew Hills, Wilson HTM:

A question regarding rebates for 2011 and I appreciate the decision will be announced in May but I am just trying to get a better idea about how you think about splitting gross income between shareholders and participants and whether that has changed recently

Robert Elstone:

Andrew I don't think it has changed recently and it's unlikely to change prospectively. I would love to stand here and tell you that there is lots and lots of science involved but that would be misleading you, it's an art. What we do is look back at historic growth rates before we set growth rate qualification thresholds and we obviously form a view about the strength of the economy and the likely outlook for the momentum of trade value activity, both in equity and futures, but at the end of the day it does come down to a judgement about trying to get the percentage uplift as fair as we can between the interests of shareholders and the interests of users. I think last year, Allan may correct me, and I think several of you were critical of us because we appeared to be too generous. I am sure if we set them the other way then users would be equally critical of us so woe is me, we just do our level best. I don't think we will be changing the technique, the methodology or the judgement that we exercise when we disclose that information around about the middle of the year as you say.

Andrew Hills, Wilson HTM:

Just one more, the increase in the debt to support the CGF and also the addition of the capital that you raised with the DRP, firstly I am just wondering why you have a DRP, whether that could come off at any time in the future or are you expecting capital, the risk based capital for ASX to increase further

Robert Elstone:

There are a number of potential contingent calls on our capital and I think we took a view at the time of introducing it last August when we didn't have the subordinated debt facility in place that the DRP probably wouldn't be in play for very many reporting periods but its certainly in play for this one and we will look at it again on the final, that's on the specifics of the DRP. On the specifics of our capital position I think we have said in my report and certainly in Alan's written words that in the environment we are going into we are quite comfortable carrying slightly more capital than the pure risk based capital allocation model that we use suggests we need to, largely because we think we are going into a more volatile period and until we have assessed what the competitive landscape is going to look like, what could come out of the CPSS - IOSCO findings in the middle of the year in terms of capital requirements on central counterparty organisations, we have just chosen to be prudent for a fairly defined and short period. I don't think you can look forward to the DRP being there for many more reporting periods but we will give more guidance on that at the end of the current financial year. I think the bottom line is we are comfortable carrying a bit more capital until the foreseeable future.

Victor German, Deutsche Bank:

Just a question on costs. You obviously had a great performance on costs throughout this crisis, would you be able to make some remarks in terms of the outlook for that particular line given that the environment is generally improving, presumably you will need to spend a bit more as well and also just in relation to the slide that Alan

provided on your global peers is that a matter of just your peers are not particularly good on cost management or is it perhaps a more competitive environment is going to force you guys to spend more going forward as well.

Robert Elstone:

On the second part of the question which is easier to answer, I don't think that hypothesis is accurate because we haven't given you a 10 year cost comparison but a 10 year cost comparison would reinforce the same cost competitive message of ASX so competition in other markets wouldn't explain away the cost base of many of the comparative exchanges. I think its just symptomatic that we are phenomenally cost efficient by any global standard for any of the recognised major exchanges so although I expect to get some complaint calls from other CEO's around the world that we put the charts up, if you went back 10 or 20 years they are going to tell you the same data all the time. On the first part, I think Alan in his report gives all the guidance that we are capable of giving on our cost profile and I won't embark on any forward looking statements on costs. I think our track record on costs is universally well-known but certainly on my watch the cost we can control will be well controlled. As to the future I suspect the D&A line will have a lot more pressure than the cash line particularly if amortisation periods for new investments shorten particularly in trade execution platforms as opposed to back end clearing or settlement platforms so there may be pressures there but I don't think I will make any more forward looking statements than Alan has made in his written word. I mean we do already provide an extraordinary level of guidance and disclosure around our cost profile.

Russell Gill, JP Morgan:

Two questions just quickly on the CAPEX program, you focused a lot on latency, last year you upgraded from I think it was May from 5,000 messages per second to 20,000, still substantially below a lot of competing platforms in the market. Just a question whether you are going to be increasing that at all over the coming periods and second question, you have accelerated the write-off of the systems in relation to market supervision of trading, my best understanding is ASIC doesn't actually have systems in place to do so, does that mean you are pretty much indicating that they are looking for a separate vendor or you are not receiving any compensation for transfer of these technologies?

Robert Elstone:

I will get you to restate your second question in a moment because I am not sure I understood what your question was. On the latency issue I think when I responded to the other gentleman's question it's not shyness I just don't want to make a complete fool of myself in the technology space. The latency the ITS upgrade that we did that I think came into effect April or May of 2009 did substantially reduce the latency so probably by a comparison to most of the incumbent exchanges around the world that brought us well and truly into line and probably better than most. Compared to some of the ECNs yes it is still lower and that's one of the reasons why we have made the capital commitment to replace the platform. On the metrics I think just watch the release that comes out from NASDAQ OMX later today after the market close. Your second question, could you restate it because you seemed to be comparing an ITS decision to the supervision system.

Russell Gill:

Yes just on the first question it was more on a question of capacity rather than actual speed.

Robert Elstone:

Oh yes the capacity metrics, clearly the upgrade we did last year took us from a maximum capacity in trades per day of around about a million to 2 million trades per day. The new system takes us to 5 million trades per day on the initial upgrade. And we would expect to refresh that in coming years as well so a lot more capacity. Latency is slightly more technical but I think you will only have to wait until the end of the day before NASDAQ OMX makes their release.

Russell Gill:

No problems, the second question was in relation to market supervision going over to ASIC. My understanding is that ASIC doesn't necessarily have the technology to monitor the market on the basis they would like to going forward where you guys effectively do retain that technology, you have accelerated the write-off of that technology I would then assume that ASIC is not going to be taking over this technology from you.

Robert Elstone:

No the accelerated write-off is related to ITS not to surveillance software so we will continue to use the SMARTS application that we use for real time frontline surveillance. We will continue to use that for price queries and continuous disclosure monitoring and I make no comments whatsoever as to what ASIC propose to do.

Chris Williams, UBS:

Thank you Robert. I have a question on the technology strategy as well, for 10 years essentially you have been moving away from external application of technology into the broker community so specifically looking at your order routing technology that's essentially an upstream move, I just wanted some comments on the significance of that recognising that many other exchanges in the competitive landscape have done a similar thing.

Robert Elstone:

I think all I can say Chris is that we don't think it would be very smart to not have a solution given that we are widening our own offering as far as trade execution services are concerned and in the event of alternative market operators receiving licenses, smart order routing by the incumbent exchange, new competitors, existing brokers just makes a lot of sense for everybody. I think some of the other global precedents where incumbent exchanges have been very slow to provide a smart order routing solution explain some of their market share losses so it just makes sense for us to go upstream as you put it. I also suspect that the technology arms race that will be kicked off late this year is going to catch a lot of small to medium size brokers out both in timing and in the extent of capital spend they will have to make in order to service their customers so I don't think it's a sort of revolutionary move I think its just a logical tactical move on our part that the more we extend the diversity of our own trade execution service offering and contemplate a multi market world it doesn't make any sense for us to sit back judgementally and say oh well we will start investing in smart order routing once we know how it works. The only reason we can't be more specific on the actual solution is it doesn't make any sense until there is clarity around

the evolution of the regulatory framework and particularly what the best execution rule looks like so we are simply flagging today that we have every intention of being early in the smart order routing space to better service our existing customers as well as to compete.

Chris Williams:

I just have a couple of points of clarification as well. You mentioned the accelerated write off or amortisation of the ITS platform. Can you quantify what is still to be amortised and the approximate time frame for that? I think it's fully written off by the end of December.

Robert Elstone:

Yes, that's what we have got to do. The ITS platform will be amortised over the period of 31 December 2010 so then it will be completely written off at that point.

Chris Williams:

So with D&A in the first half at nine and a bit million.

Alan Bardwell, Chief Financial Officer of ASX Ltd:

What we have done is accelerated amortisation over an 18 month period starting from 1 July 2009.

Chris Williams:

The second point of clarification is around Russell's question on the SMARTS surveillance system, just wondering if you would quantify again the sunk cost in that platform and other IP that sits around the supervision business so if we want to form our own judgement about the likely compensation from ASIC at least we have some premise.

Robert Elstone:

I think there are some heroic judgements in your question there. On the first part of the question which is the sunk cost, I don't have that number in the top of my head but it would be very, very dangerous to believe or assume that we send ASIC an invoice for the sunk cost, I think that would be a very short conversation.

Chris Williams:

Sure, I had one last question just looking at clearing competition and looking at the level of risk capital held particularly in your equities clearing house. The prospect of clearing competition I think seems to be getting discussed quite a lot and if you look at Europe where fees have been cut in clearing, substituted with a lot of margin calls on market participants, I am just trying to understand with your single digit return on your risk capital in that business what it means if you actually get clearing competition and competition on a risk basis rather than a returns basis.

Robert Elstone:

Can you just elaborate on what it means to get competition on a risk basis?

Chris Williams:

The risk rather, I mean are you lowering the risk threshold as opposed to actually competing on service or price.

Robert Elstone:

Well I think that's the challenge for the regulators really I mean its one thing from a regulatory policy standpoint to want competition for the service, it's a bit of a giant step for mankind if you want competition for risk because that raises systemic risk issues so I won't be drawn on the question Chris because its by no means certain notwithstanding the amount of speculation going on in the clearing and settlement space. Its by no means certain what the regulatory framework is going to look like so to form a judgement around well how would we respond or would we respond if and when there is more competition in clearing and settlement I don't think I am inclined to do that this side of seeing what level of granularity sits in the evolving regulatory framework because that will give us clues as to how we think about revitalising the service offering, what the pricing formula should be and does it impact our risk management decision making around margin setting. I think this is kind of a murky space because the whole issue of competition for clearing is a very different set of issues from competition for trade execution because of the systemic risk aspects where operational risk clearly blows out in a multi market environment and we would obviously seek to be compensated if we were going to carry extra risk.

Robert Elstone:

It doesn't look as if we have any more questions from the floor so I will invite the operator to bring in questions from other parts of Sydney or other parts of Australia.

Deana Mitchell, Macquarie Equities:

I have two questions, firstly back on the compensation issue with the government, wondering if you are still discussing whether there will be compensation on the transfer of ASIC responsibilities or the previous example you have given with regards to the US there was a compensation or whether the discussions have ceased. And the second question that I had is actually just on your information service business, you continue to see a dip in the market data terminals number as at 31 December you were down at 64,000 versus closer to 68,000 in June, has that reversed or stabilised maybe you can give an update there please.

Robert Elstone:

On the first question there has been no dialogue because we have been far more preoccupied in our dealings with ASIC in getting the foundations in place for the underlying transfer decision and the progress has been quite slow so I think it would be premature to talk about compensation because there is really nothing to say in that space at the moment. On information services and data terminals I will look to Alan.

Alan Bardwell:

Yes Deana just quickly I think there was a slight dip as you came into the end of the half year but in fact if you look at the average usage of data over the six month period you will see there has actually been a slight rebound from the prior half year so in fact actually it's a mildly positive outcome in that regard and I guess what we will have to do is see whether the slight dip that you refer to in terms of the end of the half year does that carry through into the second half but at the moment it is probably a little bit too early to reach a conclusion on that point.

Robert Elstone:

All I would add Deana is that exactly the same thing happened if you went back a year and looked at the November and December stats. The data terminals you would have seen them fall off a cliff and then they recovered by about February, March of calendar 09, I am not saying it's a seasonal trend but you do have an interesting precedent there of a year earlier.

Arjan Van Veen, Credit Suisse:

I have 2 questions on secondary capital raisings if I may. Firstly could you clarify your statement in the pack which says in your view there is "little prospect of abatement in secondary capital raisings activity". You obviously are seeing something that we can't see at the moment and secondly just on the average fees they are up 31% from the previous half and I assume that's just a mix of the number versus value of secondary capital raising.

Robert Elstone:

Yes Arjan I think both questions are actually a variation on the same question. The little abatement comment was simply that if you look at the concentration in the previous period it was obviously towards jumbo placements and rights offerings and we had no expectation that would continue on because such a high percentage of large listed companies did those forms of placements in the previous year so the little abatement comment in my commentary referred to the fact that, a) the momentum of secondary capital seemed to carry through into the second half of last year and we would expect a change in the mix more towards mid cap and smaller cap stocks where clearly our pricing regime means that in revenue terms to us we think its highly likely that the secondary capital raisings even if the volume and value of them comes down which is likely during the second half because of the mix effect in our pricing model that is not likely to translate into a revenue loss that is equivalent to the underlying reduction in activity and I think there continues to be anecdotal evidence that there is still an enormous amount of de-leveraging occurring and obviously people looking more and more to securities markets generally and away from bank debt to free themselves of the kind of covenants that are coming out of the banking sector at the moment.

Kieren Chidgey, Merrill Lynch Equities:

I have two questions; the first one is on your cash equities revenues. There's been a bit of a change in the mix obviously with settlement revenues growing at a faster rate than trading and clearing, just wondering if you can provide a bit more detail on what has driven that and whether or not you see that trend as sustainable over the near term.

Alan Bardwell:

Kieren I think I addressed it in my remarks earlier. You will see that the average trade volumes have obviously gone up a lot faster than average trade value over the six month period and you know we have seen basically a pretty much a stabilisation in terms of the proportion of settlement messages and holding statements to a number of trades which has therefore meant that as the average trade volume has gone up relative to value you have seen settlement revenues picking up relatively more than trading and clearing.

Kieren Chidgey:

So you expect volume to be a better proxy going forward for settlement.

Alan Bardwell:

Well again it would all depend on that relationship of settlement messages and holding statements to trade ratio but if it holds, if that holds fairly constant to where it is then your statement would be correct.

Kieren Chidgey:

The second question is in relation to some of your responses on the competition side. You have put out the terms for your trade acceptance late last year, just wondering if you can give us any feedback that you have had from potential competitors on that offering and I have got a follow-up question on that as well.

Robert Elstone:

No so ask your next question.

Kieren Chidgey:

The related question is obviously given that you are offering similar clearing and settlement pricing as if it was executed on your own trading platform I am just wondering how that ties in with your rebate structure, whether or not that means we will see that rebate structure shift from sitting across trading clearing and settlement to purely just sitting across trading once competition does come in.

Robert Elstone:

I personally doubt the second part of your question will become a reality but we will look at that as and when the scenario arrives is the best answer I can give you. I don't think, that at the moment and historically we have set the rebate levels as the earlier question is saying in the way that I have described the trade acceptance service (a) we would never have entertained in any way discriminatory pricing because it would have been anti competitive behaviour on our part so since the underlying security is an ASX listed security and the clearing participant is the same party that is clearing trades that come to us through our own trading platform I think the only charge we have made is the cost that we are incurring to diversify the functionality to create the service so I don't think the issue of discriminatory pricing is, it never crossed our minds, it may have crossed the minds of the aspirant operators because they think we are nasty people but we are actually quite nice people so we never even countenanced discriminatory pricing against them.

Kieren Chidgey:

I guess my point is, would the current rebate structure not lead to discriminatory pricing on a net basis?

Robert Elstone:

Well we will take that into account as and when it becomes a reality I think is my answer to that so that there is no evidence of discrimination.

Brett Le Mesurier, Axiome Equities:

Last July you increased the annual listings fees, is that the only area where you can see some margin expansion in your business?

Robert Elstone:

If you are talking about margin expansion because of pricing adjustments as opposed to margin expansion coming out of activity, look I think we review our pricing historically we have reviewed it once a year. I think if and when alternative market operators evolve we will probably review it everyday but again not wanting to be drawn on areas where we are conscious that we have a little bit more pricing power I mean we are not setting out to abuse our market power in any way whatsoever so I think that is really all I can say to you as a general philosophy.

Ryan Fisher, Goldman Sachs:

I have a question for Alan, it relates mainly to the philosophy on accruing the rebate especially in the cash market, just these are really rough calcs but it looks like compared to that first half of 09 your gross revenue in cash markets was up around 8%, can I just confirm that that's the sort of growth that you use in establishing the accrual of the rebate, my reason for asking is that the gross revenue is obviously down a lot in the second half of last year which means for the full year you are likely to have a much stronger growth rate, is that something you will just leave til the end of the year?

Alan Bardwell:

Yes Ryan we would look at it on an annual basis obviously and we are looking to build that up looking at how we are tracking on an annual basis and the other comment I would make to you is that also remember that the rebate payments are based upon a participant by participant basis so you may get one view by looking at the total growth of the market but that might be a slightly different view when you look at the growth by participant year on year and it's the participant view that would cause us to determine the level of provisions and accruals we would need to make.

Ryan Fisher, Goldman Sachs:

Can I just follow up on that to clarify, if we saw very similar activity in the second half to the first half, does that mean that is kind of already reflected in the level of rebate, that's roughly the base assumption?

Alan Bardwell:

Well yes basically of course what we have done is we have accrued based upon where we are in the year so if you had the same level of activity in the second half as the first in broad terms you would be looking at the similar amount of additional provision of the rebate accrual.