



## Edited Transcript of ASX HY 2011 Analyst Briefing

17 February 2011

---

**Andrew Hills - Wilson HTM:**

*Two questions, the first on the consultation on market structure and the second topic on the rationale for the acquisition. Firstly, the three main sticking points appear to be the consolidated tape and also the dark pools and maker-taker pricing. Can you explain a little bit better why you think it is important to have minimum size thresholds for dark pools? Also what is the justification for your negative view on maker-taker pricing and overall how are you able to develop VolumeMatch and PureMatch over the next little while there is so much uncertainty around those two topics?*

**Robert Elstone - Managing Director and CEO, ASX Ltd:**

I will jump in and let Peter [Hiom] respond as well, but I think our views on all those topics are already on the public record so I don't want to chew up a lot of time this morning and I think we can just direct investors and commentators to read our submission which would do far more justice than we can this morning. In terms of consolidated tape and maker-taker pricing, we have absolutely waxed lyrical on both of those topics in the written word so I think it is much better for people to generally read what we have already put out into the public domain and that submission is available on our website. The same thing applies to thresholds. I think Peter eluded in his comments to the fact that we are, along with other constituents who have put submissions in, we are still in formal dialogue on all of those points and we won't be making any statements at all as to how that process is going. That is up for ASIC to provide the market with clarity on, so I don't want to be a damp squib, Andrew, but everything we have had to say on all of those topics is already on the public record and we couldn't possibly do justice to the submission and I would just urge all of you to read the submission. Do you want to add anything Peter, sorry to kill that one off.

**Andrew Hills:**

*That's all right. Also in the media presentation I think it is, yes, it says and I will just read the first sentence to you: "The ASX Board maintains a strong belief in the need to participate in the global exchange consolidation", that's the first part of the sentence and then the second part of the sentence is "...and in the business logic behind the combination." Can you explain a little bit more to me about this logic, in particular? For example over the last five years or so ASX has experienced significant cut in trading fees, ASX has also got a very well developed derivatives business. Why would ASX and why would the ASX Board support a merger with an exchange which still has very high trading fees and is still light on derivatives?*

**Robert Elstone:**

I think on the business logic, I think that written extract you are quoting from, the reference is the universal drivers of scale synergies and diversification that we all learnt about at business school and I think that applies to most

sensible mergers. We do have an identity of business model with Singapore in the sense that Singapore is obviously in cash markets, derivatives markets and clearing and settlement activities so in that sense we are similar organisations. As for the long-term outlook for Singapore's trading costs, that's a matter for Singapore to opine on. All I can say is, I don't think it is likely that Singapore's trading costs will stay where they are forever-and-a-day and that was not a consideration that I, or the Board, weighted very heavily compared to all the other drivers that we took into account in making the decision that there would be good long term benefits for shareholders, and market users, in putting the two businesses together. They are clearly at a very different stage of evolution in their equity market structure and if you rewound five or seven years ago so were many other markets and they have all changed and we would expect Singapore to change. They have already made public statements about various elements of the drivers of their equity market structure which will change including technology, including development of an options market. So I don't think that particular issue, Andrew, was one we weighted very heavily compared to the benefits that we see in terms of scale, synergies, diversification as well as combining with an exchange which has an identical business model to us.

***John Heagerty - Credit Suisse:***

*Two questions if I could, firstly on VolumeMatch. I was wondering if you could comment on whether you thought the volumes so far have been above or behind expectations and what your expectations are going forward?*

**Peter Hiom – Deputy CEO of ASX Ltd:**

I think it's true to say that we are disappointed with how VolumeMatch has commenced but perhaps, certainly, not discouraged. I think we didn't underestimate the challenge of what we are taking on here, which is to try and provide - you know - a liquidity platform for large order execution that some market participants will use if it is liquid and other market participants will try and do everything they can to stop it working. So we are far from discouraged. Rob mentioned that the things we were going to say about VolumeMatch are going to be impacted by the market integrity rules, so I won't speculate on what we might be doing with VolumeMatch going forward. But I think we continue to work with a number of participants on connectivity to that platform and I think we are confident in the longer term that whether it is in its current form, or in a modified form, I don't want to leave you with any other impression than that ASX is going to participate in the space of large order execution - and how exactly that is going to work will be a function of the market integrity rules and how things play out over the next 12 to 24 months. But we are certainly not discouraged. We are no doubt disappointed that we haven't had more transactions, but we are not discouraged.

***John Heagerty:***

*Thanks, and my second question, I am probably chancing my arm here, but I was wondering if you could comment maybe on some of the other mergers internationally, particularly really on Toronto and London merger which seems to be much more of a merger of equals with the dual listing structure. And then maybe you could comment on the reference to your own structural merger?*

**Robert Elstone:**

I think I have described in my written comments John, I have referenced Toronto and London as a strategically compelling combination and I meant what I wrote in the sense that I would, and I have to be careful what I say here because I don't want to make any comments which are interpreted as being pejorative to either of those exchanges. They are very fine exchanges but strategically, I think particularly London, is in a vulnerable position because of its cash equities market concentration and its reliance on really that part of the value chain alone. It doesn't have a major derivatives franchise, it doesn't have a major clearing and settlement franchise other than

via the backdoor merger with Borsa Italiana. So I think London simply had to make a strategic move and of all the options open to it, well you pretty much know who they might have been, historically there has been obviously some relationship with NASDAQ when NASDAQ held the stake. Toronto similarly is in a challenging environment because the US border is 100 miles away from Toronto and whilst it is slightly better diversified across the value chain so I think there is logic in those two exchanges coming together, particularly given their resource orientation. If your next question is going to be well ASX has a resource orientation, why didn't you join that or will you join that, well I just won't go anywhere near the question. But I think certainly Toronto-London has some underlying logic to it beyond simply bulking up.

**John Heagerty:**

*Sorry I haven't had time to read all your material, we have had other results on as well, but I was more referring to the actual structure being more of a merger of equals and that there is a dual listing as well.*

**Robert Elstone:**

Yes I think the media is making a lot of this merger of equals, although I don't know what a merger of equals is. I think it is probably an artificial artefact designed to make people feel good, but at the end of the day sometimes it is an accident of market cap relativities that these so-called merger of equals deals are possible. But certainly as far as ours was concerned, or our announcement with Singapore was concerned, our structure simply follows the structures of the other consummated transactions in the sector. And whilst we have been questioned a lot about why didn't you do a dual listed structure, the reality is none of the exchange mergers that have been done have followed that structure. It's a particularly clumsy structure from an operational point of view and we think it is probably very, very short term in nature. But beyond that, I am really not going to say too much more because we are on the path that we are on.

**Russell Gill - JP Morgan:**

*Rob, just following on from that, the key difference obviously between the ASX and SGX transaction is that there is a cash component in relation to the transaction. Can you just talk us through why that cash component actually is in there? Was that your perspective or was it SGX's perspective?*

**Robert Elstone:**

I think that is a good question. There are a number of differences between the ASX-SGX merger proposal and those that have happened either in the past or those that were announced last week. In many respects if you look at the underlying scale of activities between ASX and SGX they are actually quite disparate. The ASX listings business is three times larger than Singapore's. The ASX trade execution business is between three and five times larger than Singapore's. So you are combining, and we think the logic in that combination beyond obvious things like time zone proximity and identity of business model is you are really combining, and this is what makes this transaction a little bit unique:

(a) it's the first transaction proposed in the Asian time zone,

(b) you are combining two exchanges which have similar business models but very, very different scales.

Arguably the ASX is a low beta exchange, the SGX is a high beta exchange.

So therefore I think the concept of a merger of equals - partly because of the market relativities, market caps were not close to equal at the time of the announcement but secondly the underlying scales of the business - and the view that we took is that while the merger makes inordinate sense because it represents a fairly unique opportunity for ASX to tap into an Asian growth story, rather than a traditional northern hemisphere growth story, that doesn't mean that a combined ASX-SGX wouldn't go on to consider mergers with other northern hemisphere

partners. It does mean that, I think, its dealing chips at the table would be much stronger if the exchanges were combined. So we took the view that it was necessary to compensate for the scale difference between the two businesses - as well as recognise the fact that since the government's announcement of the in-principle decision to grant Chi-X a license, the market view of ASX went down in response to that - and you could only consummate transactions on the terms that you have available to you. So I think that's a long winded answer to a really good question. But although it may appeal to newspapers to draw comparisons with London-Toronto or Deutsche Boerse and NYSE it's not really a very comparable transaction. The upside in the ASX-SGX transaction is merging a steady state growth exchange in a large economy with a small economy but phenomenally high growth prospect exchange, within the same time zone where ultimately we expect capital flows to be far more north-south within this time zone on a long run view that the traditional east-west UK-US centric capital flows in and out of Australia. The logic isn't a great deal more sophisticated than the response I have given you.

***Kieren Chidgey – Deutsche Securities:***

*A couple of questions if I could. Firstly on the cash equity revenues, we are continuing to see the settlement revenues decline at a different rate compared to the overall value traded and the overall revenues there, how much of that do you feel is structural and where do you see that trend going over time?*

**Robert Elstone:**

I am not sure I heard the question. I will flick it to Peter but could you speak a little bit louder Kieren?

***Kieren Chidgey:***

*The settlement revenues within the cash equity line; we saw a 15% decline in that this half on PCP, obviously value traded up 1% so it's a trend we have been seeing for the last few periods giving lower messaging and activity statements, how much of that is structural and where do you see that trend going forward?*

**Peter Hiom:**

I think there are two primary drivers there; one is that generally over the last two years there have been lower levels of retail activity which drives less transactional volume and holding statement revenues from that segment as well, and I don't think that is structural. Perhaps more so is the aggregation of settlement messaging via custodians to seek to reduce the transactional volumes in the settlement business. I think that is a long term trend you could observe through our business. I think that is perhaps the right answer.

***Kieren Chidgey:***

*A second question on the capital position: it obviously looks stronger and you are now switching off the DRP. Given you are also planning on introducing margining within cash equities around the end of this year, I am interested in your thoughts on how that could impact the capital position going forward and your ability to perhaps release fixed capital back in the clearing house?*

**Robert Elstone:**

I think the quick answer is don't hold your breath - largely because I think the intensity of focus that is going on this year at a CPSS-IOSCO level around revisions to financial stability standards in the wake of the GFC, happening in parallel with refinements to the Basel III network, particularly now the Frank-Dodd legislation has passed the US Congress. You have got, on the one hand, Basel III looking at capital weighting regimes for anticipated greater utilisation of central counterparty clearing of traditional OTC activity - which is going to raise the bar on capital requirements for CCP's almost inevitably - that is occurring at the same time as CPSS-IOSCO

is looking at whether the existing capital adequacy standards relating to stress test environments are adequate post the GFC and post the anticipated increase in throughput of traditional OTC activity coming through central counterparty organisations. I wouldn't put too much of a congruence, Kieren, in the way you have asked the question between the prospective introduction of cash margining likely to free up capital. Theoretically it should, but I think larger forces are in train and as the outcomes of these CPSS-IOSCO and Basel III deliberations occur, I suspect it is unlikely that many central counterparty subsidiaries around the world, whether they are exchange owned or not, will be withdrawing capital from their capital bases. I think that's a most unlikely scenario. If anything capital requirements could lift or even if they don't go up I suspect CCP's will move towards more of a Basel banking style - Tier 1, Tier 2, Tier 3 - type of capital requirement going forward. That shouldn't be interpreted that I am anticipating any dramatic uplift but it does mean the linkage you are drawing, I think, is likely to be overtaken by macro events in the global regulatory sense.

**Chris Williams – UBS:**

*I have two questions as well. Firstly, just to come back to Peter, you touched on the issue of ASX PureMatch. As I understand it, that platform is actually functionally ready so I am wondering what the launch strategy and game plan is there, and my second question I might come back to.*

**Peter Hiom:**

If meaning we are functionally ready would mean we could flick a switch tomorrow, that's not the case. It is on the same technology, it will be run under ASX Trade which is the underlying technology that runs TradeMatch at the moment so PureMatch will operate on the same infrastructure as is currently there, and we distribute through ASX Net so the infrastructure sits there. The functionality of the platform, again, is somewhat dependent upon where the market integrity rules come to a landing. None of that is stopping us progressing with the project. I can't speculate on a date other than to say our expectations are going to be in the six to 12 month corridor for implementation.

**Chris Williams:**

*So do we interpret that that will be used as a response to market integrity rules, market structure and competition?*

**Peter Hiom:**

I think we always said it was there for two reasons. It was one, recognising that there is a role for a high frequency trading friendly environment and the question is, is that a separate platform? But I don't think we are the first exchange in the world to also recognise that there are often ways of competing with new entrants that aren't just about the incumbent central limit order book and its full functionality being put up against that competitor. So, you know, there are elements of both of that in PureMatch.

**Chris Williams:**

*My second question is a bit more macro: coming back to the global mergers, we have clearly been looking at competition through a fairly narrow lens, looking at trade execution, arguably speculating on competition in other parts of your business domestically but it seems to me that these global mergers redefine what we understand to be competition between exchanges. Is that a fair observation, Robert? And perhaps can you opine us to what the competition, a competitive landscape might look like if and when these global mergers are consummated?*

**Robert Elstone:**

I think there is probably a part of your question which I am missing so correct me if I have missed the real point of your question. But as I interpret what you are posing is: are the mergers that have been announced, assuming they are consummated, likely to either redefine or do they have an element of combating anticipated competition outside of trade execution. Is that where your question was pointed?

**Chris Williams:**

*Correct*

**Robert Elstone:**

Look I can't speak for other exchanges that have announced mergers albeit, as you well know, I speak to my counterparts in those organisations frequently enough that I can deduce that going to Andrew's question on the business logic, clearly scale is incredibly important because it's a logical response in a sense to domestic deregulation that initially has been more apparent in trade execution than in clearing and settlement. So clearly some of it is about bulking up, some of it is about achievement of synergies and some of it is about diversification. The diversification piece I think applies (a) across the entire value chain of the exchanges that are getting together and also applies in terms of diversifying your listing offering to both listed companies and investors. So all of those rationales are in play, but I think the reality is that you are seeing this pre-GFC and now this post-GFC wave of consolidation. As I have put in my written commentary, they are entirely predictable logical responses from the incumbent exchanges to really two trends: the introduction of not only lit market competition - Chi-X and BATS - but also to me a far bigger threshold issue which is pretty much unlicensed even unregulated or poorly regulated dark pool activity. And I think OTC markets have successfully run the argument that they shouldn't be regulated because they are not doing anything which should trouble regulators. Well we saw that in the credit default swap market at the time of the GFC and we all know what the regulatory response to that has been. So I just see it as the announcements have been driven by the necessity for scale, the necessity for synergies and the necessity for diversification across the entire value chain. I don't think trade execution competition on its own would have produced the scale of merger activity that we have seen and are continuing to see.

**Brett Le Mesurier – BBY:**

*Do I take it from your comments then that we are observing round one of consolidation and part of the appeal of SGX is that it gives you the capacity to play round two on quite a significant scale?*

**Robert Elstone:**

I think you could say round one occurred pre-GFC with the three major cross border mergers being NASDAQ-OMX and NYSE-Euronext, Deutsche Boerse-ISE. So that was really round one. Things went a little bit quiet for a couple of years as PEs fell and PE relativities changed between the exchanges around the world, but also the ongoing momentum of electronic communications networks and multi-lateral trading facilities and the huge explosion in dark pool activity, particularly in Europe and the US, means that we are probably observing round two now with the three high profile transactions that have been announced. And I don't think it is likely that that activity is going to stop. I think whether we like it or not we are probably in a sector of the financial economy that is at the absolute cutting edge of globalisation: the absolute cutting edge of globalisation in the sense of global securities trading, global derivatives trading and eventually global clearing and settlement solutions. And that is a train that was unleashed probably a couple of decades ago that is not likely to stop. It is going to test the boundaries of sovereign issues and sovereign concerns and we are seeing that played out in the media every day. But that genie is well and truly out of the bottle, and I think we are going to move towards a world very similar to the airline industry of the very, very large consortium owned exchange groupings. The fact that you see BATS

looking seriously at acquiring Chi-X even means that the - I won't call them the upstarts - the relatively new entrants, are recognising the need for scale because they have carved out market share but they don't have sustainable enough market share to earn decent returns on their franchises even though they have done a good job at penetrating the incumbent exchange markets. So I think the challenge here, and there has been some good media coverage which says we really have to divorce ownership from sovereignty and we have to accept that governments have all the power that they need through their regulatory frameworks, but where the exchanges are owned and who owns them is going to become a more and more globalised issue. So I think we are probably in round two as we speak and I don't think it's a two round bout. I think there is at least three.

***Philip Parker – Parker Asset Management.***

*Following up on that. Obviously given as you said, the genie is out of the bottle and if its been comparative advantage that we live or die by: don't you think there is some sort of time pressure now that you've really got to try and link - whether it is through mergers or just arrangements with other exchanges - to be able to give the flexibility for all of the market participants to get into those markets, be they European or Asian, from our point of view, the Australian point of view?*

**Robert Elstone:**

Yes. I mean there are the time pressures for this current crop of transactions to be consummated and then in turn there will be time pressures for those combined groups to act yet again. I don't see any of the current transactions that are out there as being in and of themselves end games. I don't think Toronto-London is an end game, I doubt whether ASX-SGX is an end game and not even Deutsche Boerse-NYSE is an end game. But guessing time frames and guessing next moves is something I am not going to go anywhere near. The pressures from the end user community and the intermediary community for common access, seamless trading, seamless clearing and settlement are relentless pressures. So I think that the problem that the whole world securities and derivatives markets have got is that the economic forces are far outstripping the ability of domestic governments to come to grips with what is actually happening, and I think that is going to remain an ongoing challenge. I don't think that any slowing down is going to occur and in fact the rebound from the GFC with the Frank-Dodd legislation going through in the US if anything, is an example of a regulatory response that is going to make the train go faster in terms of the need for globally delivered trade execution platforms, globally delivered clearing and settlement platforms, so it's going to be a real conundrum for policy makers.

***Philip Parker:***

*A second question, given the huge amount of cash on corporate balance sheets at the moment, are you seeing a lift in enquiries for listings?*

**Robert Elstone:**

I think I said, if I am interpreting your question correctly, the pipeline of applications for IPOs is noticeably stronger. It is roughly running at about two-for-one compared to the prior period, albeit it with the reasonably strong bias towards the resource economies of Western Australia and Queensland very much reflecting the kind of two speed macro economy we have in Australia at the moment. How much longer that is going to last will be very much a function of how steady state our growth path is and what actions the RBA takes to moderate potential inflationary pressures. But I think for the time being we seem to have returned to a more normalised pipeline of applications for the public equity market.

***John Heagerty:***

*I was just going to follow up on Russell's question because I wasn't sure you answered it entirely. You explained that SGX was higher beta and ASX is lower beta and that side of things gives you a stronger place at the table in future mergers, I think his question was really why do you accept the cash, why not just have a sort of merger in terms of share offer or something like that, and why was that aspect different?*

**Robert Elstone:**

I think you are taking me into the zone of going over the entrails of why we have done what we have done. We took the view as a board and as a management team that whilst a merger with Singapore made inordinate sense - and we still obviously believe that which is why we are pursuing the merger - but because of the scale difference between the two businesses it was necessary on the one hand to de-risk the transaction from the Australian shareholders perspective and yet retain sufficient scrip to give them growth optionality to ride the merged beta effect of the combined exchange we represent. And I think that just goes to the answer I gave Russell, is what makes this transaction between ASX and SGX quite different to the others - and I mean this in a positive sense - I think it's an attempt to merge two exchanges who have quite different growth profiles and different franchises but within the same time zone to create critical mass of something that could be quite unique: which is a far more Australasian or westernised exchange in the Asian time zone than either Hong Kong or Shanghai or Tokyo would represent. But we took the view that the cash percentage was necessary to get the balance right between de-risking the exposure that the Australian shareholders would have if it was an all scrip deal and yet having enough scrip in the transaction to produce the growth upside of some materiality.

**John Heagerty:**

*Effectively accepting it's a Singapore takeover rather than trying to pertain that it's not?*

**Robert Elstone:**

I think that's the stuff of Hollywood and newspapers, John. I mean, the reality is we want to put the two exchanges together to produce a larger combination. The transaction was structured the way it was because the market cap relativities were not comparable at the time we announced the deal and in our view we were not going to become comparable at any time soon. I think I have answered the question on the cash portion and the scale differences between the two exchanges, and we feel that what we have come up with represents good value to the ASX shareholder and an appropriate balancing of cash and scrip to both de-risk for the growth and scale differences but actually provide enough scrip incentive to ride the wave of growth upside that we think would be available to the merged entity.

**Russell Gill:**

*Just in relation to the announcement you guys made a couple of days ago, or SGX made in relation to commitment to Australia particularly on the capex side, they are saying a minimum of 5% spend on revenue. Now SGX has a slightly more progressive IT strategy particularly around international market data centres and the like, with that sort of level of capex outside of this ramp-up in the last couple of years, is that more of a domestic strategy for you guys on that similar sort of level? Or is that really SGX's strategy for Australia?*

**Robert Elstone:**

No, I think that was more pointed at responding to either questions or perceptions that if this transaction is consummated then what possibility is there that capex could be biased away from Australia. I think sometimes people look for things which are never in the cupboard. It was simply a signal that said that's a legitimate but a nonsense question. There is a commitment to maintaining ongoing need for investment in Australia and the



measurement against revenue is in line with the historical average and the minimum is designed to head off the more mischievous type of question around the ASX side of the merged business being starved for cash or having excessive leverage put into it in order to reduce earnings. So it was simply designed as a reassurance.

*Kieren Chidgey:*

*A question on market data with the ASIC paper pending. Overseas, where we have seen consolidated data tapes and falls in traditional exchange market data revenues that's been made up by more proprietary data fees through time. I am just wondering what your view is on the demand for that and the opportunity here in Australia for more proprietary data revenues going forward if we did see a consolidated data tape?*

**Peter Hiom:**

I don't think I will comment on the impact of consolidated tape because that's again speculative and uncertain until ASIC makes its statements. But I think we have already said that we see there is opportunity, whether or not there is a consolidated tape, for new data products particularly delivered across ASX Net to customers that are either located connecting to ASX Net or inside the new data centre. I think you can expect ASX's data offering to, as in many other parts of our business, to become more complex over time.

ends