20 May 2016

CEO Speech
NZX Annual Meeting 2016

Good morning everyone. Thank you very much for coming. This morning I will cover three aspects of NZX's business. Firstly I'll give you an overview of our revenues last year and the drivers of growth over the past three years, secondly an overview of our cost base and again how that has changed over the past three years and finally look more closely at the growth prospects for two of our three business areas: Markets, and Fund Services.

Revenues

First, let me give you an overview of the businesses and how they have evolved over the past year and over the three year period 2013-2015:

- Markets: Our Markets business comprises both Capital Markets and the markets we operate on behalf of the Electricity Authority and Fonterra.
- The Capital Markets business has three components:
  - Cyclical. Initial and secondary listings revenues which are cyclical with the overall capital markets. Revenues for this part of the business were $5.6m in 2015 and 8% of total Group revenues. These were down 11% on last year but have grown 17% CAGR over the three years
  - Trading and Clearing: This was 15% of Group revenues last year, with revenues up 17% CAGR over the past three years
  - Annuity revenues: These comprise the fees we charge issuers and market participants on an annual basis, plus revenues from the sale of market data. This is the largest part of Capital Markets revenues (comprising 31% of NZX's total revenues) and grew 4% last year, and has grown 6% CAGR over the past three years
- Market Operations. The final part of the markets business is the markets we operate on behalf of Fonterra and the Electricity Authority. As you would expect, these revenues have been relatively stable over the past three years
- Funds Services. This includes the SuperLife, Smartshares and NZX Wealth Technologies businesses. This has grown from 4% of revenues when we had five ETFs in 2012, to almost 15% of revenues last year - largely through acquisition. This reflects the execution of our strategy of expanding into a higher growth and high opportunity segment of the capital markets, and also enables us to introduce new products and services to the New Zealand market
- Agri business. This includes publishing in New Zealand, data and analytics in New Zealand and Australia, and the Clear Grain Exchange. Revenues were 7% down last year and have declined 3.9% CAGR over the past three years, given the growth of the other businesses, the Agri business now only comprises 17% of revenues, versus 25% three years ago. In EBITDA terms the Agri business, which even in a more normal part of the rural cycle is lower margin than our other businesses, contributed only 4% of Group EBITDA last year

To summarise, we are starting to see a shift in our portfolio towards the New Zealand markets, and more specifically the annuity businesses within them, as our strategy for the business starts to play out. I will comment more on that shortly, but first some comments on our cost base.

Costs

Our cost base has grown over the past three years, a fact that does not escape you, our shareholders, nor the analysts that cover us. To provide a breakdown:

- Our costs have grown on an annualised basis by $14.5m over the past three years (2012 to 2015), an increase of 12% CAGR
- Of that $14.5m increase
    - $2m relates to the cost of the Ralec litigation which we expect to draw to a close this year and as a consequence will drop out of the cost base
    - $5.5m relates to the expense base of businesses acquired in 2015
    - Of the remaining $7m of the increase:
        - $2m reflects the resources required to support the Market Operations Business: Energy and Fonterra
        - $2.5m reflects the cost of launching and operating 18 new ETFs
        - $2.5m as a result of strengthening the teams in Regulation, Market Operations and Markets
- We are of course conscious of the growth of the cost base and in the two more mature businesses – Markets and Agri – costs were in fact down last year
    - Almost 1% down in Markets
    - 6% down in Agri
    - Corporate costs were down 12%

With the obvious implication that the business is beginning to show the operating leverage that we need to achieve.

A brief comment on the Ralec litigation. As James said we are unable to comment on this specifically as the trial is ongoing in the High Court in Wellington. However I would note that:

- NZX's total legal costs by the end of the trial will likely be in the order of $9-10m
- This of course excludes a significant amount of time and effort by some members of the NZX team in running the litigation
- Needless to say, it would have been in both parties interests to settle this commercial dispute before the trial
- And I would reiterate that as we noted in our 2015 Annual Report (Note 25), which provides more detail on the dispute, based on our assessment of the circumstances and the information available, NZX does not believe it is probable that a loss will be incurred as a result of the counterclaim and accordingly no provision has been recognised

Business Outlook

New Zealand's capital markets have performed strongly over the past 12 months. The S&P/NZX 50 increased by 13.6% during 2015 compared to a decline in the S&P/ASX 200 of 2%. Trade volume was up by 12% and trade value was up by 19%, a trend that has continued into 2016 with year-to-date trade volumes up 47% and trade values up 46%.

To a large extent this growth has been driven by offshore investment. Forsyth Barr estimates that foreign ownership of the New Zealand market is now 46%, more than 11% above the 10-year average.

With such a strong performance, it is unfortunate the structure of KiwiSaver has not better allowed New Zealanders to take full advantage of the growth in market value over the past few years. Treasury noted in September last year, New Zealanders' KiwiSaver investments are overweight towards income rather than growth assets; some 44% are in growth assets versus a model optimal portfolio of 56%. In total, only approximately 8-9% of KiwiSaver funds under management is invested in NZ equities.

NZX continues to focus on growing our capital markets in four areas; more products, more efficient infrastructure, a broader retail investor base, and continuing to improve our oversight of the markets.

- Products: Increasing the range of 'products on the shelf':
    - We launched the NXT market last year as an alternative for smaller high growth companies and we are pleased with the number of companies that have already listed, and the pipeline we see over the next 12 to 18 months. As we have commented on a number of occasions, the success of NXT will be judged in three to five years. As part of the SuperLife acquisition, we also launched an additional 18 ETFs, bringing the total number of ETFs to 23
    - Last year saw the listing of LGFA's $5.5b debt. This year, we are continuing to see an increase in debt listings with eight so far this year, and a corresponding increase in debt trading activity, up 60.9% YTD April over the same period last year
    - The next stage of development for the dairy derivatives market, which is the leading global dairy commodity franchise, is the launch of fresh milk futures next week which will provide New Zealand farmers with an opportunity to hedge their price risk - something that their competitors in European and US markets have had for some time
- Infrastructure: We continue to focus on reducing the cost of infrastructure within the New Zealand capital markets.
  The acquisition of NZX Wealth Technologies (formerly Apteryx) provides an opportunity to increase efficiency and reduce costs for advisors and smaller fund managers. Going forward, we are also exploring ways to leverage this infrastructure and technology that we have within the funds services business to provide easier access for wholesale fund managers to capture inflows from smaller retail investors and KiwiSaver investors.
  And we are exploring new technologies, including distributed ledger, which may contribute to a lower cost, more efficient market infrastructure for the New Zealand market going forward.
- Retail: While the government share offer programme did significantly increase retail participation in the New Zealand market, retail investment, both direct and indirect, in the New Zealand equity market remains low. The FMA released a survey on Wednesday which indicated direct ownership is 21% in New Zealand versus 33% in Australia. We have submitted on the review of the financial advisor legislation, and we are hopeful changes that have been suggested in the options paper, including robo-advice, will be implemented to encourage the development of smaller fund managers and provide easier access for New Zealanders to directly invest in the equity market.
- Regulation: Our markets continue to evolve and we are conscious of the need to continue to upgrade our regulatory capability in order to meet the changes in the market. We published last month our regulatory agenda for 2016 which sets out our programme of work with a particular focus on market rules and guidance, trading practices and market engagement. We have upgraded our policy capability and look forward to leading more of the policy debate around the advisor regime, which I just mentioned, as well as potential changes to the KiwiSaver and the funds management industry more generally. Such changes will benefit the growth of our capital markets and all New Zealanders.

Fund services
Our Fund Services business, which comprises of SuperLife, Smartshares and NZX Wealth Technologies has become a significant part of our business, comprising almost 15% of our revenues in 2015.

Our expansion into the fund management business delivers three benefits:
- A broader range of tradable products traded on NZX for retail and institutional investors
- Accelerates the growth of passive funds management in New Zealand, a gap in the market, which is shown to be a high-growth sector in other parts of the world
- Provides you, our shareholders, with an exposure to the growing funds management sector which we expect will grow in double digits for many years to come

With the acquisition NZX Wealth Technologies, we now have three offerings in high growth sectors of the market all of which have a compelling proposition for their target customers:
- SuperLife KiwiSaver: Our KiwiSaver product has one of the broadest range of investment options available in the New Zealand market with more than 40 funds to choose from including our 23 Smartshares ETFs. It is low-cost, convenient and flexible, with investors able to change their fund allocation when they want, free of fees. Last year, Consumer ranked SuperLife third out of all KiwiSaver providers for customer service. And we are starting to see the results with 28.4% growth in FuM the 12 months to April 30
- Smartshares: Retail and wholesale investors can invest directly in our Smartshares products, which as I mentioned before now has a range of 23 funds covering New Zealand, Australian and global equities, and recently launched New Zealand and global bond funds.
  While there has been some market commentary of the fee levels of these products relative to ETFs offshore, these comparisons don't take into account the foreign exchange, brokerage and custodial costs associated with offshore investing from New Zealand, nor the advantage of the PIE structure. When the 'all in' cost versus the alternatives are taken into account, along with the PIE structure, Smartshares provides a convenient and cost effective option for most NZ investors.
  We're starting to see momentum growing for ETFs in New Zealand with FuM up 10.5% YTD through the end of April - excluding the growth in units from SuperLife - with the highest growth in the Global Bond and NZ Property ETFs.
- NZX Wealth Technologies: New Zealanders have more than $110b invested in domestic and foreign equities, unit trusts, other managed funds, KiwiSaver and bond and cash management trusts. Administering these funds and advising these investors is more complex; driven by increased compliance, including anti-money laundering, different tax regimes, foreign currencies and the demand from investors for real-time reporting.
  A large amount of this administration is undertaken by what are known in the industry as wealth platforms. The two major platforms in New Zealand, Aegis, and FNZ, combined have around $20b of assets under administration.
  The NZX Wealth Technologies team, who have extensive experience in developing and operating wealth platforms, are building what NZX considers is quite simply a better product which supports a full range of investment options and the flexibility for advisors to use preferred fund managers, brokers or banks. While the business is currently cashflow negative with $1.3b of FuA, we are confident that the number will increase beyond $2b by early 2017, generating positive cash flows and more importantly establishing the business as the leading provider in the New Zealand market.

Agri Business
Our agri business accounts for less than 20% of our revenues, and as you will have noted, has been affected by the downturn in commodity prices in both New Zealand and Australia. While we continue to focus on maintaining the margins within the agri businesses, they contribute less than 4% of Group EBITDA.

Growth Prospects
So finally, what might NZX look like in three years time? Based on the performance of the business we have experienced over the past three years (bearing in mind we did not own all of them over the period), we would expect that:

- The Markets business will continue to dominate our revenues – around 60%. But importantly, the majority of these revenues come from annuity revenues streams, but potentially less exposure to IPOs and secondary raising and more exposure to trading and clearing as we expand the product offering
- Funds Services - from 15% to 25% of revenues
- Consequently, less exposure to agricultural businesses

In summary, we have a terrific team in place and have made the required investment to grow the business. The pace of cost growth, focused in the funds services business, is slowing and our exposure to higher growth segments of the capital markets is growing with momentum evident in the SuperLife, Smartshares and Wealth Technologies businesses.

The business is in great shape and we have strong prospects ahead. Thanks for your support.