Management Commentary

Financial results for the six months ended 30 June 2016

Overview

NZX's reported earnings for the six months ended 30 June 2016 (HY2016) are summarised in the table below.

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Total revenue	37,925	34,396	31,162	10.3%
Operating expenses	(27,149)	(22,685)	(19,019)	19.7%
Earnings before net finance expense, tax, depreciation and amortisation and gain on sale	10,776	11,711	12,143	(8.0%)
Net finance income	(157)	278	107	(156.5%)
Depreciation, amortisation and gain/loss on sale of PP&E	(3,893)	(3,297)	(2,712)	18.1%
Gain on sale of associate	-	11,807	-	(100.0%)
Share of profit of associate	-	411	212	(100.0%)
Impairment/earnout adjustment	(441)	-	-	NM
Tax expense	(2,708)	(2,937)	(2,780)	(7.8%)
Net profit after tax – reported	3,577	17,973	6,970	(80.1%)
Net profit after tax – excluding gain on sale of associate and impairment/earnout adjustment	4,018	6,166	6,970	(34.9%)

Revenue growth reflected:

- High volumes of activity in the capital markets, with higher listing fees as a result of substantial growth in initial and secondary capital raising and higher trading and clearing fees due to significantly higher trading activity; and
- Growth in revenues from NZX's funds services businesses due to growth in funds under management, the launch of a broad range of new Exchange Traded Funds (ETFs) throughout 2015 and the acquisition of Apteryx (subsequently renamed NZX Wealth Technologies) in the second half of 2015.

Expense growth exceeded revenue growth due to a $1.6 million increase in costs associated with the Ralec litigation, which ended in July 2016. The other drivers of the increase in costs were the increase in funds costs associated with the new range of ETFs, the acquired cost base of NZX Wealth Technologies and higher IT costs.

Included in current year earnings was an impairment charge against brand values in the Agri segment and an adjustment to the value of the provision for the earnout payment in the Apteryx acquisition. Prior year reported net earnings included an $11.8m gain on sale of the Group's investment in Link Market Services (New Zealand). Excluding these items, reported earnings were down $2.1m compared to 1H 2015 as a result of the $1.6m increase in Ralec litigation costs (which are not tax deductible), an increase in amortisation expense and the cessation of associate earnings following the sale of Link NZ.

Segment results

The breakdown of operating earnings by business segment is shown in the table below:

$000	HY2016	HY2015	Change 2016 v 2015
Segment earnings:			
Markets	19,146	17,371	10.2%
Funds Services	358	1,611	(77.8%)
Agri	291	462	(37.0%)
Corporate	(9,019)	(7,733)	16.6%
Earnings before net finance expense, tax, depreciation and amortisation and gain on sale	10,776	11,711	(8.0%)

The growth in Markets earnings is the result of the growth in capital market activity and the positive operating leverage in this business. The fall in Funds Services earnings reflects strategic investments in this segment, with both NZX Wealth Technologies and some of the new ETFs currently being loss making as the businesses build toward critical mass. The decline in Agri earnings was the result of the adverse conditions that have been impacting the dairy sector reducing spend by advertisers in the Group's publications business. The increase in corporate costs related solely to Ralec litigation expenses, other corporate costs reduced compared to the prior period.

Further details of revenue and expense movements are set out below.

Markets

Securities information revenue

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
Securities information revenue	5,063	5,430	4,929	(6.8%)
Terminal numbers (12 month average)	7,286	7,039	7,427	3.5%

Despite a 3.5% increase in terminal numbers, securities data revenue declined $367k (6.8%). Just under half of this decrease was lower FundSource revenues as this service was reviewed in 2H 2015 and was only relaunched towards the end of 1H 2016. The remainder of the decline resulted from a change in the product mix with a greater proportion of lower yielding retail and derivatives terminals and a reduced number of higher yielding professional terminals and a reduction in ad hoc revenue recoveries from audit activities.

Listing fees

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
Annual listing fees	4,486	4,232	3,834	6.0%
Initial listing fees	960	199	1,293	382.4%
Secondary issuance fees	1,223	1,047	1,075	16.8%
Total listing fees	6,669	5,478	6,202	21.7%
Number of listed issuers	232	214	207	8.4%
Equity market capitalisation	$117.8b	$100.2b	$88.4b	17.6%
Debt	$22.5b	$13.2b	$13.5b	71.1%
Number of new listings	4	2	4	
Value of new equity listed	$0.8b	$0.2b	$2.3b	438.1%
Total secondary capital raised	$1.3b	$1.2b	$0.8b	3.1%

A 6.0% increase in annual listing fees reflected growth in market capitalisation and the number of listed issuers together with price increases effective 1 July 2015.

The increase in initial listing fees was consistent with a four-fold increase in the value of new equity listed coupled with a significant increase in new debt listings.

The increase in secondary listing fees reflects an increase in and change in the mix of secondary capital raised.

Other issuer services

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Other issuer services revenue	479	382	488	25.4%

Other issuer services revenue represents billing by NZX Regulation for review of transaction documents, waiver applications, etc. The increase in this revenue resulted from the higher number of debt listings and equity transactions that occurred in 1H 2016.

Participant services revenue

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Participant services revenue	1,762	1,738	1,695	1.4%

Participant services revenues were stable, with no significant changes to fee structures.

Securities trading revenue

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
Securities trading revenue	2,971	2,330	2,221	27.5%
Number of trades	0.92m	0.68m	0.64m	35.8%

Securities trading revenue has largely increased in line with the increase in number of trades. Trading volumes increased materially in 1H 2016 due to increased offshore interest in NZX's markets.

Securities clearing revenue

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
Securities clearing revenue	2,829	2,441	2,230	15.9%
Total value traded	$22.7b	$18.3b	$17.8b	27.1%

Similar to the movement in the number of trades, the total value traded increased as a result of increased offshore interest in the New Zealand market and to a lesser extent due to growth in market capitalisation over the past 12 months. Clearing fees (which comprise approximately 50% of securities clearing revenue) were up 33% in line with the movement in value traded, however reduced stock lending fees (reflecting lower stock lending activity) and other more fixed components of the revenue base (such as annual membership fees) meant that the overall change in securities clearing revenue was lower at 15.9%.

Dairy derivatives revenue

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
Dairy derivatives revenue	221	215	88	2.8%
Lots traded	63k	79k	32K	(20.2%)

Lots traded declined 20% as a result of a reduction in volatility in underlying commodity prices reducing the need for purchasers of dairy products to hedge their price risk. Despite the drop in the number of lots traded, dairy derivatives revenue was stable – as derivative fees are priced in USD and the NZD has weakened against the USD.

Market operations revenue

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Development revenue	851	735	879	15.8%
Contractual revenue	4,451	4,693	4,538	(5.2%)
Total market operations revenue	5,302	5,428	5,417	(2.3%)

NZX successfully retendered for its market operator contracts with the Electricity Authority (EA) in 2H 2015 and the new contracts commenced in 2016. A decrease in price for the existing contracts was offset by additional work to upgrade the systems used to run the market, the revenue for which is included in the annual billings across the eight year initial term of the contracts. While EA revenue was stable, the small decrease in contractual revenue was the result of a decline in non-EA revenue.

Development revenue increased as a result of the continuation of the Extended Reserves Manager project coupled with a variety of smaller system changes completed under change requests.

Funds Services

Funds management revenue

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
SuperLife revenue	3,426	3,150	-	8.8%
Smartshares revenue	2,393	1,691	1,217	41.5%
Total funds management revenue	5,819	4,841	1,217	20.2%
SuperLife member numbers	44,948	42,197	-	6.5%
SuperLife FUM	$1,502m	$1,328m	-	13.1%

Smartshares external FUM	$468m	$438m	$375m	6.8%
Smartshares SuperLife FUM	$1,113m	$166m	-	571.7%
Total Smartshares FUM	$1,581m	$604m	$375m	161.8%

SuperLife revenue comes from a combination of membership fees and fees billed based on a percentage of Funds Under Management (FUM). The 9% increase in revenue reflects a blend of member growth and FUM growth.

The funds invested by SuperLife into the ETF products launched during the course of 2015 was the largest contributor to the 42% growth in Smartshares revenue. While reported growth in external Smartshares FUM was 6.8%, this was reduced by the transfer of the smartkiwi KiwiSaver scheme from Smartshares to SuperLife. Adjusting for this, the underlying growth in external Smartshares FUM was 15.5%.

Wealth platform fees

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
Wealth platform fees	720	-	-	NM
FUA	$1,311m	-	-	NM

NZX acquired the Apteryx wealth management platform business in 2H 2015 (subsequently renamed NZX Wealth Technologies). Accordingly, there is no equivalent revenue in prior periods.

Agri

Agri information revenue

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
Publishing revenue	3,342	4,028	4,457	(17.0%)
Agri data revenue	1,979	1,636	1,547	21.0%
Total agri information revenue	5,321	5,664	6,004	(6.1%)
Total paid advertising page equivalents	889	1,000	1,210	(11.1%)

The difficult conditions that impacted much of the rural sector in 2015 have persisted in 2016. The dairy sector has been particularly hard hit by persistently low prices for milk powders. This has seen farmers cut back on spending and with lower demand, rural businesses have cut back on their advertising spend. This resulted in the 11.1% decline in paid advertising page equivalents.

In light of the adverse market conditions, one marginal publication was closed in 2015, which accounted for approximately $150k of the decline in advertising revenue. The remainder was the result of the reduction in spend by advertisers.

Approximately half the increase in Agri data revenue came from iFarm, which was acquired in H1 2015, as there was a full six months of revenue in HY 2016 compared to two months in the comparative period. The remainder of the increase is the result of continued growth in subscriptions to NZX's agri data products.

Commodities trading revenue

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
Commodities trading revenue	769	449	671	71.3%
Total tonnes traded	389k	242k	317k	61.0%

The increase in commodities trading revenue reflects the different selling pattern in the 2015/16 harvest relative to the previous period. Prices have been lower in the current harvest which has resulted in a more drawn out sales profile as growers wait for a lift in prices. Lower sales were recorded in H2 2015, with more volume shifting into H1 2016.

Operating expenses

Personnel costs

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Wages and salaries	(13,420)	(11,523)	(9,006)	16.5%
Contractor costs	(1,353)	(1,033)	(1,270)	31.0%
Other personnel costs	(506)	(476)	(374)	6.3%
Gross personnel costs	(15,279)	(13,032)	(10,650)	17.2%
Less capitalised labour	1,395	522	159	167.2%
Reported personnel costs	(13,884)	(12,510)	(10,491)	11.0%

Of the $1.9m increase in wages and salaries, $1.1m was from NZX Wealth Technologies which was acquired in 2H 2015. The residual $0.8m increase reflects additional fixed term employees engaged to complete the upgrade of energy systems under contract to the EA, fixed term employees engaged to backfill staff seconded to the clearing system upgrade project, restructuring costs and salary increases.

The increase in contractor costs was also largely related to energy consulting and development projects.

The increase in capitalised labour came from the clearing system upgrade project, the EA development project and platform development at NZX Wealth Technologies.

Information Technology costs

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Information technology costs	(3,615)	(2,946)	(2,872)	22.7%

Of the $669k increase in IT costs, $120k came from NZX Wealth Technologies. A further $200k resulted from the impact of changes in exchange rates on foreign currency denominated licence fees. The remainder resulted from increased data centre and network costs.

Professional fees

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Ralec litigation expenditure	(2,930)	(1,309)	(333)	123.8%
Other professional fees	(1,054)	(1,233)	(1,041)	(14.5%)
Total professional fees	(3,984)	(2,542)	(1,374)	56.7%

Costs associated with the Ralec litigation, which was heard in the High Court between May and July 2016, were the primary driver of the significant increase in total professional fees. The increase in costs reflected the increase in activity leading up to and during the trial. No further significant costs are expected to be incurred after July and a judgment in the case is currently anticipated before the end of 2016.

Other professional fees decreased slightly as a result of legal fees incurred in the prior year for the launch of new ETFs. This was partly offset by additional costs in HY2016 for FMCA transition activities within the Funds Services segment.

Marketing, print and distribution

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Marketing, print and distribution	(1,605)	(1,676)	(1,745)	(4.2%)

Print and distribution costs declined as a result of the closure of one of NZX’s agri publications in 2H 2015.

Fund expenditure

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Fund expenditure	(1,681)	(773)	(413)	117.5%

The significant increase in fund expenditure reflects the increase in the number of Smartshares ETFs from seven to 23 during the course of 2015. Each additional fund has its own fixed costs (including administration and accounting fees, index fees, trustee fees and other compliance costs) which add to fund expenditure. With no further funds launched in 2016, this cost growth will level off in 2017.

Other expenses

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Other expenses	(2,380)	(2,238)	(2,124)	6.3%

Other expenses increased modestly as additional costs from NZX Wealth Technologies were partly offset by an increase in capitalised overheads in line with the increase in labour capitalisation.

Other income and expenses

Net finance income/(expense)

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Interest income	521	506	275	3.0%
Interest expense	(625)	(533)	(133)	17.3%
Net gain/(loss) on foreign exchange	(53)	305	(35)	(117.4%)
Net finance (expense)/income	(157)	278	170	(156.5%)

Interest expense increased as a result of the drawdown of $10m of debt in August 2015 to increase the capitalisation of the clearing house in line with growth in trading activity (particularly derivatives). The loss of foreign exchange largely arose on the revaluation of Australian operations.

Gain on disposal of associate

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Gain on disposal of associate	-	11,807	-	NM

NZX sold its 50% stake in Link NZ on 30 June 2015. A gain of $11.8m was realised on this sale in HY 2015.

Depreciation and amortisation

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Depreciation of PP&E	(653)	(590)	(461)	10.7%
Amortisation of intangibles	(3,241)	(2,675)	(2,251)	21.2%
Gain/(loss) on sale of PP&E	1	(32)	-	NM
Total depreciation and amortisation	(3,893)	(3,297)	(2,712)	18.1%

The increase in depreciation resulted from capital expenditure in 2015 on the refit of the company's Wellington head office and NZX Wealth Technologies assets, while the increase in the amortisation of intangibles reflects the amortisation of software acquired in the acquisition of NZX Wealth Technologies.

Share of profit of associate

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Share of profit of associate	-	411	212	(100.0%)

The share of profit of associates came from NZX's 50% interest in Link Market Services (New Zealand) Limited. This ceased upon the sale of the Link NZ stake on 30 June 2015.

Impairment expense and earnout adjustment

$000	HY2016	HY2015	HY2014	Change 2016 v 2015
Impairment expense	(793)	-	-	NM
Adjustment to provision for earnout	352	-	-	NM

NZX has recognised an impairment of part of the residual value of brand assets in relation to NZX's agri business, reflecting future expectations for rural publications.

The provision for the NZX Wealth Technologies earnout was calculated at 31 December 2015 based on a probability weighted range of possible outcomes. As a result of reassessing these probabilities as at 30 June 2016, the provision has been adjusted downwards by $352,000.

Tax expense

($000 unless otherwise stated)	HY2016	HY2015	HY2014	Change 2016 v 2015
Tax expense	(2,708)	(2,937)	(2,780)	(7.8%)
Effective tax rate (excluding non-assessable gain on disposal of Link)	43.0%	32.3%	28.5%	

The effective tax rate is higher than the statutory rate of 28% due to the significant expenditure on the Ralec litigation which is not deductible for tax purposes. The increase in the effective tax rate compared to the prior period reflects the significant increase in non-deductible Ralec expenditure.