Q412 Earnings Call Prepared Remarks
February 5, 2013

- **<u>Gill</u>**
  Thank you for joining us today.

- I am going to highlight CME Group's 2012 major efforts and then share some thoughts about 2013. Afterwards, Jamie will review our Q4 financial results.

- Despite facing a low-volatility and difficult environment in 2012, we made significant progress across several key areas as we are embracing the changing regulatory and global landscape. Looking forward to 2013, we remain cautiously optimistic about the trading environment relative to last year. Based on what we have been working on, we feel that we are very well positioned to benefit most when we come out of this challenging cycle.

- We experienced improved activity in December 2012 and January 2013 in comparison to what we saw during much of 2012. Average daily volume in December was up 1 percent year over year, with an increase in many asset classes. January average daily volume was 11.4 million, a nice jump from the 10.5 million contracts per day we averaged during the second half of last year. In addition, open interest is up 13 percent since the end of the year and is currently above 79 million contracts.

- Turning to interest rates, the last two months were each up versus the prior year. January average daily volume was more than 5.3 million contracts per day, the highest volume levels since June of last year, and up 24 percent from the 4.3 million averaged during the second half of last year. The short end of the interest rate curve is still hindered by the zero interest rate policy, which has negatively impacted Eurodollar activity. On a positive note, our Fed Funds Futures product is currently indicating a rate increase during Q4 of 2014, which has moved up from mid-2015.

- At the long end of the curve, our treasury products are performing well with January 2013 average daily volume up 30 percent versus the same period last year. On February 1st, we traded a record number of treasury options approaching 1.2 million contracts, with more than half of that volume on CME Globex. Clearly, market participants are watching economic data very closely, with the yield on the 10-year rising above 2 percent recently. Longer term catalysts for our interest rate products include the OTC mandate beginning in March driving more revenue in swap clearing as well as increased activity in our futures products, the continued resolution of regulatory uncertainty, and improved confidence about the economy.

- In light of these catalysts, we are building our interest rate product suite and our focus remains on driving activity out the curve, examining new interest rate products, and building our OTC swap business, which could potentially drive greater use of our core futures and options products.

- Moving on to OTC, we have seen a ramp up in activity leading to the CFTC clearing mandate, with phase one set to begin in March. So far, over 60 institutions have cleared trades at CME, comprising a wide array of market participants including asset managers, hedge funds, insurance companies, GSE's, and proprietary trading firms. Since launch, we have cleared $1.6 trillion and open interest is above $850 billion. 2013 is off to a strong start with many new customers onboarding and clearing their first trades, and many existing customers increasing their activity. January 2013 average daily notional was over $12 billion, compared to $6 billion and $4 billion in the fourth and third quarters 2012, respectively. We also added eight additional clearing members in 2012, bringing our total to 23.

- Overall, there are three ways for us to help customers navigate the regulatory changes: cleared swaps, existing rate futures contracts, and new innovative products, and we are executing on all fronts. We now clear the seven major interest rate swap currencies that account for 95 percent of the market, 51 CDS indices, and the 12 most active emerging markets NDFs. In addition, we received regulatory approval to implement portfolio margining for all market participants. Initial results are promising, as these participants have seen significant risk offsets that account for margin savings of over $1 billion. Looking forward, we expect to grow the list of cleared OTC products as well as launch interest rate swaps clearing out of our European Clearing House in Q1, well ahead of the mandate there.

- We also had a successful deliverable swap futures product launch in December 2012 with strong buy- and sell- side support. There is significant interest in this new innovative product and it is off to a solid start with approximately 65,000 contracts traded to date representing $6.5 billion in notional value, and current open interest above 12,000 contracts representing $1.1 billion in notional value. Although we have had nice volume following the launch, many potential clients are focused on the first roll in March, and the upcoming clearing mandates in March and June, which will focus more attention on the benefits of this product compared to the alternatives.

- In addition, we received CFTC approval for our swaps data repository for CDS, IRS, Commodities and FX asset classes. Our SDR will offer customers the ability to optimize their existing connections to CME Clearing for automatic SDR reporting, which will facilitate straight through processing, providing further value to our clients. We are excited about this as a natural extension of the clearing and processing services we offer to both sell- and buy-side clients, providing a compliant, efficient and low-cost way for market participants to access an SDR.

- Turning to FX, January 2013 ADV was up 21 percent versus the prior January. We are seeing particular strength in the Yen and British Pound contracts, up 160 percent and 41 percent, respectively. FX options continue to be particularly strong with Q4 ADV up 17 percent versus the prior year, and up 56 percent in January compared to last year. We also hit multiple open interest records for Japanese Yen last week.

- In terms of Open Interest, we experienced record levels of FX open interest, ending 2012 up 15 percent compared to the end of 2011. In addition, FX products hit a new all-time high of "Large Open Interest Holders" in December of 890, up from 860 in September, indicating that more customers are holding increasing amounts of FX risk at CME Group.

- Average daily volume in our FX business in December 2012 surpassed the volumes of all of the OTC FX platforms for only the 2nd time ever. This speaks to both success in building and diversifying our participant base as well as the FX market's increasing adoption of exchange-traded and cleared products in the form of CME FX Futures and Options.

- We also continue to see improvements and new opportunities within our Energy complex. On January 11, the Seaway pipeline increased its capacity to 400,000 barrels per day from 150,000 barrels per day and we saw a tightening of the WTI-Brent spread and look forward to further tightening in the future as more WTI reaches market. In addition, since the 11th, we have seen more volume traded in CME's WTI futures than our competitor's Brent contract. Looking forward, the significant increases projected in U.S. production could lead to more hedging based on WTI, and lower imports, which are typically linked to Brent.

- We believe there will be three global, crude benchmarks going forward; our WTI, Brent and DME Oman contracts. We intend to be successful in all three. Although still early in development, we have recently hit record volume levels in our Brent and DME contracts, and open interest in Brent continues to grow. Also, DME Oman is going to be included in a new U.S.-based commodities fund, United States Asian Commodities Basket Fund, which will give investors exposure to Asia's rapidly growing demand for raw materials. This inclusion recognizes the critical benchmarking role DME is playing in the expansion of the East of Suez markets, providing transparent price discovery and reflecting the economics of the Asian region like no other crude oil futures contract. We are making a very concerted effort to meet the hedging needs of our global customer base and expand our market share in 2013 and beyond.

- Shifting to our globalization efforts, we accomplished a lot in 2012 and look to build on that momentum in 2013. In 2012, we continued to ramp up our sales and marketing efforts globally, and we have launched a number of regionally specific products including Black Sea Wheat and Chinese Steel Rebar Swap Futures, which are directed towards meeting unique risk management needs in particular geographies. We also continue to expand our global footprint and applied to the Financial Services Authority to register a London-based derivatives exchange, CME Europe, which we anticipate launching in mid-2013. In addition during 2012, we strengthened our international partnerships, including implementing our cross-listing and cross-licensing arrangement with BM&FBOVESPA, and increasing our stake in the Dubai Mercantile Exchange to help build the new benchmark for crude oil East of Suez that I referenced earlier. Lastly, we advanced our efforts in China and India, including helping to facilitate operational readiness of several Chinese FCMs to trade our products, and recently launching Indian Rupee futures.

- In addition to our globalization efforts, we continue to enhance and further diversify our core. We completed the acquisition of the Kansas City Board of Trade and our integration is progressing well since closing the transaction at the end of November. The hard red winter wheat ADV was up 25 percent in December versus a year ago and the implied inter-exchange Wheat futures spread became available on CME Globex on December 10th. Our customers will realize further efficiencies as we complete the largest two milestones of the integration in the coming year. In mid-April, we will consolidate clearing services under CME Clearing, and we plan to transition all floor trading to Chicago beginning on July 1st, subject to CFTC review.

- Additionally, in 2012, we launched the next generation of CME Globex reducing order entry and market data latency variability along with increasing capacity and cost efficiency. We also launched CME Direct Technology for online trading of both exchange-traded and OTC markets. In addition, we closed our joint venture with McGraw Hill securing the long-term exclusive license on S&P futures and OTC swaps. And finally, we launched our co-location business to create a valuable new revenue stream and had a successful first year.

- In summary, we remain extremely focused on future opportunities, while investing in the right places and maintaining financial discipline to reward our shareholders. We have a lot to be proud of as a company, but a lot of important work still needs to be done. 2013 is going to be a busy year for us given all that we have planned as we position the firm for future growth. We are prepared for what lies ahead, and we look forward to continuing to build upon our world-class business.

- Now, I will turn the call over to Jamie to discuss the financials.

Jamie

- Thank you Gill and good afternoon everyone. Today, I am going to review the results of the quarter and provide you with details around how we are positioning ourselves for 2013 and beyond. Excluding the tax entries mentioned in the release, our earnings per share would have been 63 cents.

- Let me start the detailed discussion on the quarter with revenue –

- The rate per contract for the fourth quarter was 83.1 cents, up 2 percent from the fourth quarter of 2011 and up 1 percent sequentially. Compared to last quarter, a larger percentage of the business was from non-members, and we saw lower volume discounts and incentives, which are correlated with volume.

- Within the market data line, we saw a sequential drop of $3.5 million related to a reduction in screen counts due to intensified focus on headcount and cost reduction in the financial services industry as we closed the year.

- Total fourth-quarter operating expense was $285 million. It is important to note that in the fourth quarter we reclassified 2012 Clearing House bank facility fees of $8.6 million from Other Operating Expenses to Interest Expense in the Non-operating section of the income statement. Otherwise, expenses would have been $294 million.

- Breaking down operating expense in more detail, starting with Compensation and Benefits, this line item was $113 million, down from $118 million last quarter due to a $1.4 million sequential benefit from deferred compensation expense and favorable vacation accruals and severance costs. Our bonus was $12 million for the quarter, similar to the prior quarter. Our annual bonus in 2012 was down approximately 25 percent vs. 2011.

- Our headcount ended the year at 2,566, basically flat for the year, with small net hiring at our technology center in Northern Ireland which results in lower overall expense, due to less reliance on outside consultants.

- Turning to non-compensation expense, the main items that increased sequentially were marketing, as we projected last quarter, and technology support services, driven by greater annual maintenance costs. Many of the other items came in favorably relative to our expectations from last quarter's call.

- Turning to non-operating income, we received $6 million in dividends from our various investments, down from $10 million last quarter. Interest expense jumped to $44 million driven by the reclass of the credit facilities costs I already mentioned and a full quarter of interest expense related to the $750 million note issued in September 2012.

- Capital expenditures net of leasehold improvement allowances totaled $42 million in the fourth quarter and $140 million for the full year, down over 10 percent from the prior year.

- The pro-forma tax rate was 40.1 percent in the quarter.

- Turning to the balance sheet, we had $1.7 billion of cash and marketable securities at the end of December. Despite the headwinds throughout the year, we continued to generate significant cash, returning more than $1.2 billion to our shareholders in 2012. Our dividend yield for 2012 approached 7 percent, or 4.5 percent if you exclude the accelerated variable 5th dividend paid in December. We have received positive feedback on our novel dividend policy and will continue to consider and pay out a fifth dividend for each year.

- Let me now turn to guidance for 2013.

- First on Revenue.

- Starting with the access and communications fees line – at the end of 2012, our co-location customers had an opportunity to modify their infrastructure footprint upon renewal of their contracts. As this was their first opportunity to do so since the initial commitments they made in late 2010, many customers took the opportunity to adjust, reflecting current business needs. While, the number of customers has remained fairly consistent, we expect a reduction of about $3 million per quarter in 2013 within this expense line driven by both co-location and other access fees.

- Turning to expense. For 2013, we expect approximately $1.25 billion of expenses for the year based on our assumption of top line growth. In addition to normal inflation, there are three primary areas to point to including bonus expense, investment in growth initiatives leading to higher staffing and a new marketing campaign. In 2013, as we do every year, we are resetting our bonus estimate to the target level of approximately $68 million. Remember, bonus expense had seen a significant pull back in 2012 based on lower than expected cash earnings. Each year we reset the cash earnings target to reflect current and projected market conditions and business goals.

- After remaining relatively flat over the last 12 to 18 months in terms of headcount, we expect to resume hiring in 2013 including additional technology employees in Northern Ireland, additional staffing of our European exchange and clearing house, and some new positions related to regulatory compliance efforts in clearing and market regulation.

- The other driver of the expense increase is a branding and advertising campaign to rebuild confidence in the derivatives market. The incremental marketing cost for the campaign is approximately $10 million in 2013.

- Our expense projection assumes cash earnings growth in 2013. Should 2013 cash earnings come in flat versus 2012, we would project expenses to be approximately $1.23 billion.

- For interest expense, we are projecting $39 million per quarter, which includes the costs associated with the increase in the size of both our corporate and clearing house credit facilities. This will decrease once our debt maturing in August is retired, but may go back up temporarily if we decide to prefund the debt maturing in February 2014.

- In terms of tax rate, we expect between 38 and 39 percent in 2013, down from the prior year due to the full impact of the Illinois state apportionment change and other tax efficiencies.

- Lastly, in terms of capital expenditures, in 2013 we expect CAPEX to be approximately $140 to $150 million, the same guidance we had going into this year.

- In summary, we continue to focus on investing for the future; in particular we want to position ourselves to fully take advantage of the changing regulatory and competitive landscape. As always, we also remain intensely focused on generating and returning excess capital to our shareholders, while also investing in our future.

- With that, we'd like to open the call up for your questions. Only one question and one follow up please.

trading capabilities, and our ability to maintain the competitiveness of our existing products and services, including our ability to provide effective services to the over-the-counter market; our ability to adjust our fixed costs and expenses if our revenues decline; our ability to maintain existing customers, develop strategic relationships and attract new customers; our ability to expand and offer our products outside the United States; changes in domestic and non-U.S. regulations; changes in government policy, including policies relating to common or directed clearing and changes as a result of legislation stemming from the implementation of the Dodd-Frank Act; the costs associated with protecting our intellectual property rights and our ability to operate our business without violating the intellectual property rights of others; our ability to generate revenue from our market data that may be reduced or eliminated by the growth of electronic trading, the state of the overall economy or declines in subscriptions; changes in our average rate per contract due to shifts in the mix of the products traded, the trading venue and the mix of customers (whether the customer receives member or non-member fees or participates in one of our various incentive programs) and the impact of our tiered pricing structure; the ability of our financial safeguards package to adequately protect us from the credit risks of clearing members; the ability of our compliance and risk management methods to effectively monitor and manage our risks, including our ability to prevent errors and misconduct and protect our infrastructure against security breaches and misappropriation of our intellectual property assets; changes in price levels and volatility in the derivatives markets and in underlying fixed income, equity, foreign exchange, interest rate and commodities markets; economic, political and market conditions, including the volatility of the capital and credit markets and the impact of economic conditions on the trading activity of our current and potential customers stemming from the financial crisis that began in 2008 and any other future crises; our ability to accommodate increases in trading volume and order transaction traffic without failure or degradation of performance of our trading and clearing systems; our ability to execute our growth strategy and maintain our growth effectively; our ability to manage the risks and control the costs associated with our acquisition, investment and alliance strategy; our ability to continue to generate funds and/or manage our indebtedness to allow us to continue to invest in our business; industry and customer consolidation; decreases in trading and clearing activity; the imposition of a transaction tax or user fee on futures and options on futures transactions and/or the repeal of the 60/40 tax treatment of such transactions; the unfavorable resolution of material legal proceedings and the seasonality of the futures business. More detailed information about factors that may affect our performance may be found in our filings with the Securities and Exchange Commission, including our most recent periodic reports filed on Form 10-K and Form 10-Q, which are available in the Investor Relations section of the CME Group Web site. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.