Q409 Earnings Call Prepared Remarks

John

Thank you for joining us. Craig Donohue, our CEO, and Jamie Parisi, our CFO, will spend a few minutes outlining the highlights of the fourth quarter, and then we will open up the call for your questions. Also joining us for participation in the Q&A session are Terry Duffy, our Executive Chairman, Rick Redding, our head of products and services, and Phupinder Gill, our President.

Before they begin, I'll read the safe harbor language. Statements made on this call, and in the accompanying slides on our Web site, that are not historical facts are forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or implied in any forward-looking statements. More detailed information about factors that may affect our performance may be found in our filings with the SEC, including our most recent Forms 10-K and 10-Q, which are available in the Investor Relations section of the CME Group Web site.

During this call, we will refer to GAAP and non-GAAP pro forma results. A reconciliation is available in our press release, and there is an accompanying file on the investor relations portion of our Web site that provides detailed quarterly information on a GAAP and pro forma basis.

Now, I would like to turn the call over to Craig.

Craig

- Thank you for joining us today.

- There has been much said about the challenges of 2009, and CME Group certainly wasn't exempt from such challenges. However, looking back at the year, I am pleased with the progress CME Group has made and the platform we've built for the future. From the start of the year to the end, we sought opportunities amongst the challenges, and we were steadfast in pursuing and executing on those opportunities. I'm tremendously excited about how CME is currently positioned to pursue future growth.

- To highlight a few of our key accomplishments over the past year:

    - We successfully integrated NYMEX and COMEX into CME Group. In addition to the strong recent growth trends in energy and metals volumes, which I'll discuss in greater detail in a moment, we've been working on several strategic fronts to leverage this asset:

        - We've implemented global sales and marketing plans that include increased education and sales outreach to energy and metals customers, cross-selling across asset classes, and extending our international incentive programs to these customers.

        - We've completed the clearing and technology integration of NYMEX and COMEX and achieved the full $60M in run rate synergies.

        - We've built on the success of the CME ClearPort platform by launching 332 new products in 2009 and have plans under development to continue adding asset classes.

- We've also scaled our technology for future growth. While exercising great expense discipline, we continued our ongoing focus on providing best-in-class technology by bringing online a new, state-of-the-art data center. As part of this effort, we migrated the FX and equities complexes to new match engines, and customers have benefited from significant performance improvement; we will migrate other asset classes over the next year. The flexibility of the new data center positions us well for future volume growth, ongoing performance improvements, and enhanced customer services.

- We see technology as helping us deliver better performance to our existing customers, as well as helping to attract new customers. As we have identified in the past, we are actively pursuing a broader global customer base. Over 2009, we made progress on several fronts in moving towards this goal:

    - We worked on extending our global relevance by increasing the breadth of products we offer on Globex and developing key relationships with local regulators and market participants in several emerging geographies around the world. We continued to strengthen our BM&F Bovespa partnership, launched the KOSPI 200 on Globex during non-Korean hours, and signed an agreement with Bursa Malaysia to provide Globex order routing and matching services for their derivatives segment, which will also provides us with a license to use their Crude Palm Oil settlement prices for future product development.

    - We are very pleased with the success we've seen with these partnerships, and believe that they provide us with a strong base to aggressively market the full suite of CME Group products in those geographies. We are focused on positioning ourselves around the world to serve the customers of today, as well as the customers of tomorrow.

    - As a measure of our global penetration, we increased our non-US hours trading volume to 19% in the fourth quarter, up from 17% in the third quarter. While it is difficult to track precisely, we attribute much of this growth to targeted sales efforts in Europe and Asia.

  - Finally, on the over-the-counter front, we initiated the pre-launch of our over-the-counter cleared credit default swaps offering in December with eight Dealer Founding Members and six Buyside Founding Members. We continue to actively work on several tracks to complete the steps necessary for our public launch, targeted for the end of the first quarter. Most importantly, we see the progress there as a strong foundation for the long-term success of other over-the-counter offerings.

- Beyond all that I've just described, we were also hard at work managing the core business, and in spite of the difficult climate, saw significant improvements there.
  - Total open interest at CME Group grew from 63M at the start of 2009 to 78.0M at year end, an improvement of 24%. January has seen continued growth, to 85M.

  - Interest rate volumes were the most heavily affected by the credit crisis. Over the course of the year, we saw volume growth of 14% from the first quarter to the fourth quarter. More recently, January 2010 interest rate average daily volume of 4.8M is up 33% from January 2009. Several macroeconomic factors that drive interest rates have stabilized over the course of the year, including improvements in liquidity and credit spreads, but areas of weakness remain.

  - The upcoming announced exit of the Fed from its mortgage-backed securities purchase program and its winding down of several temporary liquidity facilities are both a vote of confidence in the metrics that indicate a recovery is under way, and a welcome step from markets that are eager to function based on fundamentals. It is difficult to predict timing, but these and other improving factors should contribute to a more active interest rate climate.

- With macroeconomic factors beyond our control, we continued to work closely with customers on new product development, and are pleased with the success of our most recent launch, the Ultra T-bond Futures. This is the most successful new interest rate product launch in CME history, in terms of volume and open interest growth since launch. Open interest currently exceeds 40K, and we've seen good volume participation across multiple customer types using the products for a variety of needs. All of these factors bode well for our ability to grow this product over the long term.

- Equities volumes showed strength early in 2009, as lack of liquidity in other asset classes and high volatility drove volume, but were challenged by declining volatility during the third and fourth quarter. A return of volatility over the last two weeks of January brought volumes to 3.5M during that time period, up 67% from volumes in the first half of January.

- The fourth quarter was a record quarter for energy, fx and metals volumes, which were up 21%, 57%, and 59% respectively from the third quarter. All of these product areas continued to show robust volumes in January as well.

♦ Beyond our core business and strategic growth initiatives, the other key area of focus for management in 2010 continues to be working with our regulators to ensure that derivatives markets retain their hallmarks of effective price discovery, safety and security.

- Before concluding, I want to briefly touch on the status of ELX's attempt, through a rule filing with the CFTC, to compel CBOT to create or liquidate open positions without any corresponding transaction permitted by CBOT rules. The CFTC has not required us to take any action or modify our rules. I want to make absolutely clear that CBOT's rules remain in full force and effect and that CBOT and CME Clearing have not been directed to accept directions from ELX or any of its members to open, liquidate or transfer positions in accordance with ELX's EFF rule. We are engaged in a dialogue with the CFTC regarding CBOT's rationale for its long standing rules prohibiting these types of transactions. As always, we are working closely with the Commission staff. We have and continue to take these issues very seriously and are confident that the CBOT is operating in strict compliance with its statutory self-regulatory responsibilities and the requirements of the Commodity Exchange Act. Given the ongoing nature of our discussions with the CFTC, I do not intend to make any further comments on this issue at this time, and we thank you in advance for respecting that.

- There are a variety of additional regulatory issues under discussion at the moment. CME Group appreciates the significance of the credit crisis and the ensuing focus on market structure, systemic risk and regulatory reform. We believe our politicians and regulators fundamentally recognize the value of transparent, centrally cleared markets and that this recognition is reflected in much of the proposed legislation outstanding. In the aggregate, there are few areas of potential harm to our business, and many areas that are potentially favorable for CME Group and other exchanges.

- As always, we will continue to work to educate law makers and regulators on the forces that drive our markets and how we can best maintain the secure, efficient markets.

- In summary, in spite of all the challenges of the year, we successfully managed the aftermath of the credit crisis and are now emerging well positioned for future growth. With fundamental market drivers achieving sustained stability, our core products are showing improvements in volume and open interest. We have executed on the early stages of our over-the-counter clearing and global expansion strategies, and look forward to continuing to build these efforts for long-term success.

- I will now turn the call over to Jamie to discuss our financial results.

Jamie

- Thank you Craig.

- CME Group turned in a strong fourth-quarter financial performance, generating more revenue than any other quarter in 2009.

- Our GAAP results are summarized in the press release. Today, I'm going to focus on the details for Q4 on a pro forma basis.

- During Q4, **average daily volume** was down 1 percent compared to the fourth quarter 2008 to 10.2 million contracts per day. We generated $667 million in **revenue,** and **operating expenses** were up 6 percent from the prior quarter this year, slightly less than we guided to last quarter. This resulted in $409 million of **operating income** and **diluted earnings per share** of $3.37.

- In terms of **customer segmentation**, we saw numbers for the fourth quarter remain largely in line with third quarter results. Proprietary buy side traders contributed 43 percent of overall volume. Hedge funds accounted for 8 percent of volume, showing a slight increase in contribution for the third quarter in a row. Bank trading accounted for 13 percent of volume, other member activity, 20 percent, and non-member activity, 16 percent. This segmentation is for legacy CME/CBOT products only. We will be providing more detail for the entire CME Group product suite beginning next quarter.

- The **overall pro forma rate per contract** for all CME Group volume decreased 2 percent to 84.9 cents, compared with 86.6 cents in the fourth quarter 2008, primarily due to lower priced interest rate volume increasing from 36 percent of total a year ago to 43 percent this quarter.

- Sequentially, the rate per contract increased 1.5 cents from 83.4 cents to 84.9 cents due to a 1 percent increase in the metals proportion of the product mix, and favorable pricing impacts from changes implemented in August and September of 2009.

- **Market data revenue** of $82 million for the quarter, decreased six percent versus last year and was up 1 percent sequentially. At the end of the fourth quarter, users subscribed to 396,000 base devices across CME, CBOT and NYMEX, down 9 percent versus Q4 of last year, and down 1 percent sequentially. During Q4, we had a benefit from a billing adjustment, which resulted in positive sequential revenue growth. We have announced a professional screen fee increase from $55 to $61 per month beginning in January of 2010.

- I'll now take a few minutes to review **expenses**.

- **Total pro forma operating expenses** were $258 million for Q4, down 2 percent versus Q4 last year, but up $14 million or 6 percent sequentially. Total expense for the year was $998 million, down 8 percent, as we delivered the NYMEX related synergies and ratcheted down our discretionary expenses.

- Drilling into Q4 expenses, **compensation and benefits** was up $4 million sequentially to $88.6 million due primarily to higher stock based compensation. **Stock based compensation** was $9.9 million in the fourth quarter, up $3 million from Q3 of this year. We moved our stock option grant date from mid-June to mid-September, and some prior year grants rolled off in June resulting in lower Q3 expense. Our **combined headcount** at the end of Q4 stood at 2,260, up slightly relative to the prior quarter.

- Our fourth quarter **bonus expense** was $11.8 million, and for the full year the bonus expense totaled $39 million, down 13 percent versus 2008.

- **Non-compensation expenses** of $170 million were down $6 million versus last year and up $10 million sequentially. Comparing to last quarter, the primary increases were in the Professional Fees line, up $4.7 million due to fees associated with our strategic initiatives and miscellaneous litigation, and in the Other Expense line, up $4.4 million due to increased marketing costs primarily related to sponsored conferences and currency fluctuations.

- Q4 pro forma **operating income** was $409 million, the high water mark for 2009. During the fourth quarter, we were able to maintain a very strong pro forma **operating margin** of 61 percent, and we finished the full year with an operating margin of 62 percent compared to 64 percent in 2008. We view this as a significant achievement in light of the challenging environment throughout last year.

- In the **non-operating income and expense category**, on the investment income line, we received a $5.0 million dividend from BM&F/Bovespa, in line with Q3.

- During Q4, we paid down $225 million in **debt**, and as of the end of December, we had $2.3 billion of **debt outstanding**, and $303 million of **cash and marketable securities**. **Interest expense** totaled $30.7 million in Q4. During the quarter, we continued to pay down our debt by rolling less commercial paper, which carried a rate of less than 0.3 percent in the quarter. We expect our interest expense to remain at a similar level to Q4 for the next two quarters. After paying off $900 million of debt during the year, our **debt to ebitda ratio** is down to 1.2. Looking forward, we have a $300 million payment due in August, and we intend to pay off the remaining debt instruments on their maturity dates. The detail related to our debt structure is included in our earnings slide presentation on the Web site.

- For the quarter, our pro forma **effective tax rate** was 41.2 percent – bringing us to 41.1 percent for the year. Looking to 2010, we expect an effective tax rate of between 41 and 42 percent.

- **Capital expenditures**, net of leasehold improvement allowances, totaled $43 million in the fourth quarter and $137 million in 2009, driven primarily by data center, software, equipment and facilities costs.

- At this point, I would like to provide some insight and **guidance** related to our plans for 2010. First, on **operating expenses**, our normal growth rate from 2001 to 2007 was 8 to 10 percent. In 2008, our proforma expenses dropped 2 percent, followed by an 8 percent drop in 2009, during a period in which we benefitted from the synergies captured on our recent mergers and we compressed discretionary spending as far as we could – including some items which were one-time in nature.

- As the economy shows signs of emerging from the recession, our outlook on growth is improving and in 2010, we expect a return to more normal expense growth levels, resulting in **annual 2010 expense** of approximately $1.1 billion. Within **compensation**, after holding salaries flat in 2009, we expect a 5 percent increase due to merit and promotion adjustments for employees and to the impacts of new hires. In terms of **stock based comp**, we expect a similar quarterly run rate as we saw in Q4 of approximately $10 to $11 million per quarter. Lastly, our **bonus expense** totaled $39 million in 2009, down from $45 million in 2008. Looking ahead to 2010, our **target employee bonus** is $54 million, based on reaching our internal 2010 cash earnings target. If our cash earnings for the year are 20 percent above our cash earnings target, **employee bonuses** would be approximately $82 million. If we are more than 20 percent below our target, the bonus would be a minimal amount for non-exempt employees.

- The **non comp expense** increase from 2009 is expected to come in many of the technology oriented expenses as we are aggressively building out our new data center. In addition, **Marketing and Other Expense** is expected to rise during 2010 to roughly $23 million a quarter on average, and it is likely to be more front-end loaded. This higher level is attributable to advertising, promotion and travel expenses driven by our desire to both expand our global reach, as well as our OTC capabilities. **Licensing and fee sharing** will likely rise based on continued growth in our energy and equity businesses. As always, during 2010 we will continue to spend on growth. We anticipate deploying additional OTC products, bringing the European clearing house on line during the year and working on various other strategic initiatives.

- Turning to **capital expenditures**, as I mentioned earlier, we spent $137 million in 2009, well below our original 2009 guidance, and down from $205 million in 2008. In 2010, we anticipate between $180 and $200 million of capital expenditures driven by technology related projects, as we now populate our new data center.

- In summary, we are proud of our results during a challenging year. We made incremental progress during 2009 after a fairly large shock to the financial system. We were very careful on expenses, and at the same time we continued to make investments in growth as reflected in our signing of various global partnerships and laying the groundwork for significant OTC clearing opportunities. And finally, we are optimistic about the strong start to 2010 with January volume averaging 11.2 million contracts per day, up 19 percent versus January 2009.

- We will now open up the call for your questions, but, in order to get to everyone, we are limiting all of you to one question and one follow up, and then please feel free to get back in the queue if time permits.

Statements in this document that are not historical facts are forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or implied in any forward-looking statements. Among the factors that might affect our performance are: increasing competition by foreign and domestic entities, including increased competition from new entrants into our markets and consolidation of existing entities; our ability to keep pace with rapid technological developments, including our ability to complete the development and implementation of the enhanced functionality required by our customers; our ability to continue introducing competitive new products and services on a timely, cost-effective basis, including through our electronic trading capabilities, and our ability to maintain the competitiveness of our existing products and services; our ability to adjust our fixed costs and expenses if our revenues decline; our ability to generate revenues from our processing services; our ability to maintain existing customers, develop strategic relationships and attract new customers; our ability to expand and offer our products in foreign jurisdictions; changes in domestic and foreign regulations; changes in government policy, including policies relating to common or *directed clearing ; changes in government policy, including policies related to common or directed clearing and changes as a result of legislation stemming from the recent financial crisis, including the proposed regulatory reform of the over-the-counter derivatives and futures market and any changes in the regulation of our industry with respect to speculative trading in commodity interests and derivative contracts; 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 or declines in subscriptions; changes in our 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; changes in price levels and volatility in the derivatives markets and in underlying fixed income, equity, foreign exchange and commodities markets; economic, political and market conditions, including the recent volatility of the capital and credit markets and the impact of current economic conditions on the trading activity of our current and potential customers; our ability to accommodate increases in trading volume and order transaction traffic without failure or degradation of performance of our 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 on futures and options on futures 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.*

Non-GAAP Financial Measures

In this document we refer to non-GAAP financial measures, including pro forma results that assume the merger with CBOT Holdings and acquisition of NYMEX Holdings were completed as of the beginning of the period presented. A reconciliation of these measures to our GAAP financial results is available in the company's latest financial statements in the Investor Relations section of the CME Group Web site.