CME Group - Q215 Prepared Remarks – July 30, 2015

Phupinder Gill

- Thank you Mr. Peschier, and thank you for joining us today. We had an impressive second quarter and the diversity of our product offerings was evident in the results achieved. We delivered significant top line growth in transaction fees and market data revenue, which, coupled with lower expenses, resulted in a 23 percent increase in earnings per share.

- After an industry slowdown in April, our volume finished the quarter with June up 15 percent compared to the prior June. ADV across all six product areas were up in June, and four of them were up in double digits. Our commodities portfolio was up 26%, while financial products increased by 12 percent.

- In terms of Q2 activity, in our commodities portfolio, we saw strong results with ADV up 22% across energy, ags and metals. In Ag's, we delivered record quarterly volume in Corn, Soybeans and Wheat. The surge in activity was driven by concerns of an El Nino in the equatorial Pacific Ocean, resulting in anticipated increased rain in the US and Brazil, and potential drought conditions in Australia and South East Asia. The resulting price movements, volatility and declining prices has sparked renewed hedging activity in both futures and options.

- Energy volumes also performed extremely well in Q2, with ADV up 20 percent, driven by 32 percent growth in our crude complex with 68 percent of our WTI options now trading electronically on Globex. In June, Nat Gas results trended well, as volume rose 30 percent and nat gas options were up 37 percent, as our market share also rose. Total energy volume and revenue were each up 20 percent, double that of our primary competitor.

- Within the financial product area, foreign exchange trading growth was significant during the second quarter, rising 42 percent. FX futures were up 38 percent, while FX options grew 83 percent. Interest rates volumes accelerated during the quarter from 5.1 million per day in April to 7.4 million during the rest of the quarter. Interest rate activity at CME has performed well relative to substitute products that were out there and were up 7 percent. Our penetration of the cash treasury market increased from 77 percent at the end of Q1 to 78 percent this quarter. In addition, the total number of large institutional open interest holders in our rates futures business grew to 1,705 at the end of the quarter, which is up 7 percent from the beginning of the year.

- We are particularly pleased with the activity in Eurodollar options ahead of a potential FED move. Eurodollar options on Globex were up 60 percent to 148,000 contracts per day during the quarter, and up 84 percent in June. Importantly, we have seen the percentage of Eurodollar options traded electronically move from 12 percent in Q2 last year, to 18 percent this year, and up to 22 percent in July. The biggest driver has been a surge in activity coming from European traders. In addition, we had a record number of weekly treasury options traded in June, at 140,000 ADV. July remains extremely strong, as well. Lastly, Fed Funds futures have become popular again for the first time since the credit crisis. Volume has tripled from last year so far in 2015 - ADV is above 60,000 contracts compared to 20,000 last year.

- During the quarter, our revenue in interest rate swap clearing grew by 36 percent, while credit default swap clearing was up 11 percent, to total approximately $18 million. We have seen a slowdown of activity in swaps in July, due to the basis spread between CME and LCH. The basis has stabilized and tightened recently. The OTC swaps revenue trajectory for July looks similar to April, based on the client mix, as the decreases we have seen are mainly in lower priced OIS trades coming from large hedge fund clients. On the flip side, we have seen a record number of Dealer to Dealer trades, which is encouraging.

- We continue to look at opportunities to address challenges our customers are facing. There has been a decline in cash market liquidity in the government securities markets, due in part to more stringent capital, leverage, and liquidity standards for banks and heightened regulatory scrutiny, and this may have contributed to the increased client use of the Treasury futures product. We also had a webinar this Tuesday, with a large number of market participants to discuss the concept of filling the 15 year gap between the 6.5 year point tracked by our 10 year treasury contract and the 21.5 year point tracked by our 30 year long bond.

- Turning to our global business. Work by our staff and volume from outside of the US continues to be impressive. Our Q2 electronic trading volume out of Asia jumped 22 percent from the second quarter last year with the highest volume growth in our FX and equity product areas. Europe was up 10 percent, with Ag products up 50 percent, and FX was also strong. North America and Latin America were each up 6 percent. Electronic volume from outside the US was up 12 percent, and revenue was up 19 percent.

- Turning to growth in our robust Options market – we continue to invest in system enhancements, new products and investor education which is driving significant usage of our diverse suite of Option products. Q2 ADV rose 13 percent to 2.6 million contracts, with electronic volumes up 29 percent compared to the prior year. In July, options volume remains extremely strong. Overall, 53 percent of our options traded electronically in June, up from 50 percent in 2014. As I mentioned on the Financials side, we are seeing strong growth in Eurodollar options, weekly treasury options, and also fx options. On the Commodities portfolio, we are seeing strength in WTI options, and agricultural products, with July running at peak levels in these commodities. I think that suggests that market participants are anticipating more volatility ahead. After some enhanced volatility in early July with the situation in Greece and large movements in the Chinese equities markets, activity has returned to the normal summer/vacation mode. However, the Options positioning suggests that market participants are looking ahead.

- So, overall we continue to execute on our strategy to deliver growth in a highly efficient way throughout the organization.

- With that – I am going to turn the call over to John to discuss the financials. Thank you

John Pietrowicz

- Thank you Gill, and good morning everyone.

- I am pleased with our results this quarter. We drove double digit organic revenue growth, while our expenses decreased, driving in significant operating leverage and EPS growth. Q2 revenue was up 12 percent, which follows the 8 percent revenue growth we delivered in Q1. Volume in the second quarter started slow, but finished exceptionally strong. Our adjusted expenses for the quarter were down 1 percent from the same quarter last year, driven primarily by decreases in marketing and other costs and professional fees. Our variable costs, license fees and bonus increased due to our improved performance compared to last year. Our operating margins are again above 60 percent, with an adjusted operating margin of 60.5 percent, which improved from 55 percent a year ago. Finally, our adjusted EPS grew 23 percent during the quarter, up from 18 percent growth in Q1.

- I'll start with some revenue details:

- The rate per contract for Q1 was 77.7 cents, up from 75.3 cents last quarter. The largest impact was driven by a favorable shift in product mix with record agricultural commodities propelling the RPC higher. The other positives include a larger proportion from higher paying non members in several product areas, lower volume tier impacts, and, lastly, our pricing change that went into effect in February.

- OTC swaps revenue totaled $18 million for the quarter, up 35 percent versus $13 million last year. During the second quarter, we captured $139 per IRS cleared trade, an increase from the $130 range which we have been averaging. We cleared approximately 1,950 trades per day in Q2, up 38 percent from a year ago.

- Market data revenue of $103 million was up 15 percent versus Q2 last year, driven primarily by the elimination of our fee waiver program, which we have discussed the last few quarters. Fortunately, we saw better than expected screen counts for both grandfathered and full paying customers in the second quarter. We will continue to monitor the impacts of the fee changes, and we currently anticipate about $100 million per quarter of market data revenue for the remainder of 2015, based on potential attrition from here.

- Adjusted operating expenses in Q2 were $324 million, down $3.4 million from Q2 last year. We remain extremely focused on driving efficiency throughout the organization, and eliminating redundancy to improve agility, and customer and market responsiveness.

- At the end of Q2, we had 2,650 employees, down 20 from the end of Q1 and down 30 from the beginning of the year. In July, we eliminated an additional 60 lower level positions related to the closure of most of our futures pits in Chicago and New York. Within the compensation line, our base and benefits were down 2 percent from last year and down 1 percent from last quarter. The stock based compensation increased approximately $5 million sequentially. This was driven almost entirely by the performance share component of our equity program, which is based on total shareholder return relative to the S&P500 and cash earnings generation during the 3 year period from 2013 through 2015. Based on the fact we are tracking well above the 75th percentile of the S&P500 in total shareholder return, as well as being ahead of our cash earnings target, we expect to reach the maximum payout and we accounted for it this quarter.

- Our compensation ratio for the first half of the year is running at an industry leading 16.5 percent, down from 17.1 percent in 2014 and 17.4 percent in 2013.

- Turning to taxes, the effective rate for the quarter was 36.6 percent. I expect the second half of the year to come in around 37 percent.

- And now to the balance sheet – at the end of the quarter and after refinancing our debt which we covered last quarter, we had $1.33 billion in cash, restricted cash and marketable securities. That is approximately $630 million above our $700 million minimum cash target.

- During the second quarter, capital expenditures, net of leasehold improvement allowances totaled $28 million, and we are at $55 million for the year to date. We expect full-year 2015 CAPEX to come in at $140 million, similar to last year, and below our original guidance of $150 million.

- For the full year, we expect adjusted expenses to be $10 million lower than we had previously guided to at $1.3 billion, down about 1 percent from last year, despite our current double digit revenue growth.

- In summary, the second quarter of 2015 once again demonstrated the power of the CME Group business model. Broad based volume growth and our disciplined expense management drove adjusted EPS up more than 20 percent. The entire management team continues to focus on driving earnings growth as we come out of the cycle and returning the maximum amount of capital to our shareholders. In the last few months, we have closed the majority of our futures pits, reduced overall headcount, consolidated data centers, and reduced branding related costs.

- With that, we'd like to open up the call for your questions. Given the number of analysts who cover us, we ask that you limit yourself to one question, so we can get to everyone. Please feel free to get back into the queue, if you have further questions. Thank you.

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 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; our ability to accommodate increases in contract volume and order transaction traffic and to implement enhancements without failure or degradation of the 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 strategy for acquisitions, investments and alliances; 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 repeal of the 60/40 tax treatment of such transactions; the unfavorable resolution of material legal proceedings; and the seasonality of the futures business. For a detailed discussion of these and other factors that might affect our performance, see our filings with the Securities and Exchange Commission, including our most recent periodic reports filed on Form 10-K and Form 10-Q.