Q307 Earnings Call Prepared Remarks
Oct. 24 final

John

Thank you for joining us. Terry Duffy, our Executive Chairman, Craig Donohue, our CEO, and Jamie Parisi, our CFO, will spend a few minutes outlining the highlights of the third quarter, and then we will open up the call for your questions. Phupinder Gill, our president, and Rick Redding, our head of products and services have also joined us this morning and will participate in the Q&A session.

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 Quarterly Report on Form 10-Q, which is 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 website that provides detailed quarterly information on a GAAP and Pro forma basis.

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

Terry

- Thank you for joining us this morning. As you all know, we closed our merger with CBOT in mid July, and we proceeded to post the strongest quarter in our history, with records across the board. Our success in the third quarter, offered a glimpse of what our combined capabilities will be going forward. We are in the process of positioning ourselves to reap the benefits of the growing need for innovative risk management products, available around the clock, and delivered in a highly reliable and efficient way.

- In August, the financial markets encountered turbulence and users increasingly turned to CME Group to manage their risk. Overall CME Group volumes in the third quarter rose by 49 percent, driven primarily by strength in our financial products. Our e-mini equity product line lead the way, up 83 percent compared to the same quarter a year ago, followed by FX up 50 percent, and interest rates up 43 percent. The energy and metals products we trade on behalf of our partners at NYMEX, reached a record for the fifth quarter in a row, with volume quadrupling from a year ago.

- Next, I want to update you on our integration planning. So far, the process is running very smoothly. We are on track for the cutover of CBOT products onto CME Globex, which will happen in two phases. First, on January 13th, we will add CBOT commodity and equity products, and on January 27th, we will add the CBOT interest rate products. We have provided a Globex certification testing environment for customers since mid-August, and we have been working with over two dozen front ends and proprietary firms as they test CBOT products on Globex. Mock trading is slated to begin on December 1st. In terms of the trading floors, beginning in March, we will move CME floor traded equity products to our CBOT location, followed by CME interest rate and FX products in April, and we will finish with our commodity products in May. Construction is underway on the expanded floors at the CBOT location.

- In summary, the merger between these two great exchanges is progressing well. And while we are pleased with our Q3 results, we continue to look forward. Craig will update you on our progress.

Craig

- Thank you Terry. As he mentioned, our integration process is going well. In addition, we said all along that our ability to combine the CME and CBOT quickly, based on the tremendous efforts of our teams, positioned us to immediately pursue valuable growth opportunities, which were evidenced by our announcements yesterday.

- We have discussed our long-term strategy extensively in the past. Our strategy is to innovate and launch new products, increase revenues from our third-party transaction processing business, launch new non-core businesses in the high growth over-the-counter markets and to expand globally.

- Today, I am going to focus on our efforts to expand globally. We announced yesterday that we have signed a non binding letter of intent with respect to a proposed a pre-IPO equity investment in the Brazilian Mercantile and Futures Exchange, known as BM&F, which is the world's fourth largest futures exchange. CME Group will acquire a 10 percent equity stake in BM&F in exchange for approximately 2 percent of CME Group, at the close of BM&F's initial public offering, which is expected to occur later this year. The investment is subject to negotiation of definitive documentation and BM&F regulatory and shareholder approval.

- BM&F is the largest and most successful derivatives market in South America, with average daily volume on a year to date basis of 1.8 million. Through August, BM&F volume is up approximately 69%, as you can see on slide 8 in our attached slides. On the next slide you can see the product breakdown for BM&F. Their largest product line is interest rates followed by foreign exchange and equity index futures. Similar to CME, BM&F is largely a pure play derivatives exchange, and they are also vertically integrated with their own clearing house. Brazil has emerged as the world's tenth largest economy, and the ability to develop and link our markets creates significant opportunity for our customers and shareholders.

- In addition to the cross-equity agreement, the letter of intent also contemplates the establishment of an order-routing arrangement in which CME Group would connect its CME Globex® electronic distribution network to BM&F, and BM&F would connect its distribution network to CME Globex, for the routing of orders for electronic trading of the products of both exchanges.

- CME Group and BM&F also expect to enter into memorandum of understanding to consider additional commercial arrangements, Which may include the following:

- We would connect the CME Globex electronic distribution network to BM&F for the routing of orders for all electronic transactions in BM&F products.

- CME Group would provide offshore collateral management services to the BM&F clearinghouses for non-Brazilian Real denominated collateral.

- BM&F would become a "super clearing" member of CME Group in order to facilitate access to CME Group products on behalf of BM&F market participants that lack independent arrangements with CME Group clearing members, and

- CME and BM&F to work together to develop and market new products for the Brazilian and South American markets to take advantage of the expertise, distribution and resources of both exchanges.

- We are very impressed with the leadership team in place at BM&F, and we look forward to working with them in the years to come. BM&F is currently in a quiet period associated with its IPO. Out of respect for that process, we are limited in terms of providing details or projections. We will provide you additional information further down the road.

- Also, yesterday we announced that CME Group and the Korea Exchange, a premier exchange in Northeast Asia, intend to enter into a processing agreement for the KOSPI 200 futures contract to be listed on CME Globex, beginning in 2008. The five-year agreement would include the creation of a telecom hub in Seoul and will be the first time KRX has entered into a processing agreement related to its popular Kospi products. More than 32 million Kospi 200 futures, based on the Kospi 200 stock index of the largest South Korean companies have traded so far this year through August. CME will match the trades, with KRX continuing to clear and settle their products. The contract, would trade from 2am to 3pm Chicago time, or 5pm to 6am Seoul time.

- Asia is a vital area of long-term growth for both CME Group products and our transaction processing services and we look forward to providing our world class platform. We believe this agreement, is an important step to expand our reach.

- These two developments illustrate the value CME Group can provide as a partner of choice for other exchanges around the globe. From our perspective the true globalization of the derivatives markets is in its infancy, and we intend to be a leader in this area. We have created the world's fastest, most widely distributed and reliable derivatives trading platform in CME Globex, and we have the world's leading clearing house. Our goal is to offer world class processing services to our partners, enhancing their ability to grow. We have two very good case studies of that with NYMEX and CBOT, which were large important processing agreements, which displayed our ability to leverage the scalable infrastructure we have built.

In conclusion, we continue to execute on our business model on multiple fronts. As Terry mentioned, the August time period was extremely busy and we met the challenge.

Greater uncertainty causes institutional traders in this environment to turn to us. They demand deep pools of transparent, anonymous liquidity and from a capital perspective – safety and efficiency. Our regulated futures business is the beneficiary of these customer demands, and while we are in early stages of penetrating the larger OTC markets, we are nonetheless excited to deploy our existing capabilities in a meaningful way.

- Now, I would like to turn the call over to Jamie to discuss our third quarter financial results.

Jamie

- Thank you Craig.

- By all measures, the third-quarter was one of the greatest ever for CME Group. While handling record trading volumes, our rate per contract was down only slightly, while we began to reap the benefits of our merger and continued to leverage our systems and distribution.

- The GAAP results for the third quarter were outlined in detail in the press release. In summary, we delivered net income of $202 million or $3.87 per share including CBOT-related results after July 12th. Included within these results were $20 million of merger-related operating expenses and $28.5 million of merger-related non-operating expenses. Additionally, we made a few revisions to the presentation of the income statement. On the revenue side, we combined access fees with communication fees, and building revenue with other revenue. On expenses we combined occupancy with building, marketing with other, and we added an amortization line and a restructuring line. We provide a reconciliation between GAAP and pro forma results in the back of the press release, and we have also posted both GAAP and pro forma historical quarterly income statements on our Web site, starting with Q1 of 2006.

- Pro forma results exclude merger related costs of $20 million in the third quarter. This can be broken into four components. First, we recorded a payment of $6 million for the settlement of the class action lawsuit between Lampers and CBOT. Second, we incurred integration and legal expenses of $6 million. Third, we had $4 million of restructuring expense, driven primarily by headcount reductions, and lastly, we booked $4 million of accelerated depreciation associated with decommissioning CBOT's data centers. In addition, we had $28.5 million of non-operating merger-related expense related to the guarantee of the CBOE exercise right privileges. The CBOT results from July 1st to July

12th were included in the pro forma numbers, which added $20 million of revenue, $9 million of operating expense, and $7.3 million of net income.

- From this point forward, I am going to provide comparisons based on the pro forma results.

- Our **total pro forma revenue** rose 41 percent to $585 million for the third quarter, increasing $172 million compared with the same quarter last year, driven by strong CME Group and NYMEX trading volumes. CME Group average daily volume was up 49 percent while the average rate per contract was down less than 2 percent compared to Q3 2006.

- Our **average rate per contract** was 62.2 cents in Q3, down from 63.2 cents in Q3 last year and 63.9 cents in the second quarter of 2007. The primary driver of the sequential drop in the RPC was the impact of our volume discounts, particularly in foreign exchange products. In addition, growth in lower fee member volumes outpaced the growth in non-member volumes.

- **Quotation data fees** were $49 million for the quarter, up 12 percent from $44 million in Q3 of 2006. At the end of the quarter, we had approximately 287,000 users paying for the base devices on a combined basis, up more than 1,000 compared to the second quarter. Beginning in January of 2008, we will be increasing our fee per market data screen from $50 to $55. This increase may be offset somewhat by decreased demand due to the price sensitivity of some customers and the impact of staffing declines on Wall Street.

- Our processing services revenue, which is now driven primarily by our NYMEX agreement, was $15.3 million, tripling from $5.2 million in Q3 2006. During the third quarter, we handled more than 800,000 NYMEX contracts per day, up from 710,000 contracts in Q2, and 175,000 contracts per day in the third quarter of last year. During this quarter we averaged 29 cents per contract based on our NYMEX agreement.

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

- **Total pro forma operating expenses** for Q3 were $211 million, up 7 percent versus $197 million for Q3 last year. Comparing to the second quarter of this year on a combined basis, expenses were virtually unchanged, despite a revenue increase of $75 million sequentially. Compensation expense was up $4.3 million, while non-compensation related items were down $4.3 million.

- Total compensation-related expense increased sequentially from $76 million to $81 million. There are three components of this expense: salaries and benefits, bonus and stock-based compensation. Salaries and benefits totaled $56 million, down $4 million sequentially. This was driven by our reduction in headcount beginning in August, which reduced our workforce during the quarter by approximately 130 people. As of September 30th, the CME Group headcount stands at 1,990. Next, our employee bonus accrual totaled $18 million, up $8 million sequentially due to our superior performance during Q3. Our maximum bonus for the year is $47 million, and through three quarters we have expensed $34 million. And finally, the stock based portion of compensation was $7 million, up $1 million from the prior quarter.

- All other expenses totaled $130 million in the third quarter, down $4.3 million sequentially. We saw an increase in the volume-related expenses, specifically license fees, which was offset by a reduction in discretionary expense, particularly in marketing and public relations, which we expect to return to normal levels in Q4.

- Operating margin was 64 percent on a pro forma basis, our highest quarter ever.

- Moving on to the **equity in losses of unconsolidated subsidiaries**, it totaled $3.7 million, basically at similar levels compared to the past 2 quarters. We expect the loss to come in at a similar level in the fourth quarter and we will update our 2008 guidance for

FXMarketSpace when we report our 2007 year-end financial results.

- Our **pre-tax income** was $393 million in the quarter, up 68 percent from the third quarter last year. Net income for the quarter was $236 million and diluted pro forma EPS was $4.31.

- Moving on to the **balance sheet**:

- At the end of the second quarter, we had $1.95 billion in cash and marketable securities. In the third quarter, we spent approximately $1.5 billion on the fixed price tender, CBOT dividend and ERP payment. As of September 30th, we have $898 million of cash and marketable securities, and short-term debt of $165 million related to the fixed price tender offer resulting in a net cash position of $733 million.

- **Capital expenditures**, net of leasehold improvement allowances, totaled $39 million in the third quarter, driven by continued investment in our technology infrastructure and leasehold improvements. We previously gave guidance of second half CAPEX of $95 to $105 million, which we continue to expect, resulting in Q4 CAPEX of $55 to $65 million.

- Including yesterday's volume, our average daily volume in October is approximately 9.2 million contracts, up 14 percent vs. the same period a year ago.

- The financial power inherent in our business model has never been more apparent than it was in this quarter. On a year-over-year basis, pro forma revenue grew by $172 million, while expenses rose only $13 million. This represented incremental margins in excess of 90 percent. Our team is very focused on the opportunity to improve on our performance by delivering the merger-related synergies we outlined, while continuing to seek out and deliver on growth opportunities.

- With that, we would now like to open up the call for your questions.