Q115 Prepared Remarks – April 30, 2015

Phupinder Gill

- Thank you John, and thank you for joining us today. I am very pleased with the progress we have made since the beginning of the year in terms of our growth initiatives and our volume relative to market conditions. Also, our efforts on the expense side are clearly evident in our Q1 results and I applaud our team for their efforts.

- During the first quarter, our ADV reached almost 15 million contracts which was the second highest volume quarter in our history. We had record energy volume, up more than 20 percent, and interest rates and FX volume each grew by more than 10 percent. Some notable quarterly records included overall options ADV of 2.8 million contracts, as well as records in WTI and Brent crude, gasoline and heating oil products.

- Energy volume has been very robust overall this year. We've had standout results with our WTI crude oil contracts relative to the other primary crude benchmark. Year to date, our WTI futures and WTI options are each up more than 60 percent, and combined we have averaged 1.1 million contracts per day so far this year.

- Turning to FX, activity has been impressive and FX volumes averaged about 725 thousand per day in the first half of last year, that number jumped to about 875 thousand in the second half, and we saw almost 1.1 million contracts per day in March of this year. In April, we are trending up about 40 percent compared to last year. Certainly, you have heard about positive trends in the FX activity on several of the large banks earnings calls. Open interest in FX continues to run at peak levels. With the upcoming election in the UK and the ongoing debate about what the FED will do, we expect to continue to see some interesting activity in our FX markets.

- Moving on to our interest rate quadrant, after a strong first quarter we have seen a slowdown in activity since the dovish sentiment from the Fed Meeting in mid-March, coupled with a normally slow April and Easter holiday period. Weaker economic data tends to push expectations of a Fed rate move further out, as evidenced in our Fed funds futures markets, while making the ebb and flow of the rate-decision debate even more dependent on upcoming economic data in the spring and summer months. Volatility in rate products have dropped in April, which you can see in the slides. We are fortunate that we have a very diverse product set, which is important when volume fluctuates like it does every year.

- As I mentioned last quarter, we are focused on three primary areas of organic growth – increase penetration of global clients, attracting flow from the swaps business through clearing and exchange-traded alternatives and driving options growth across the platform, which elevates futures volumes as well.

- Volume from outside the US continues to be impressive as we leverage our investments in global headcount, partnerships and product development. Our Q1 electronic trading volume out of Asia reached a record 570,000 contracts per day, up 22 percent from Q1 of last year. That was double the 10 percent growth we saw out of North America during the quarter. Energy volume led the way in terms of product line growth from Asia, followed by FX and equities, all up more than 40 percent. Clearly, Asian clients are comfortable trading and clearing directly with a US-based exchange.

- Average daily volume from Europe grew by 14 percent to 2.3 million contracts, led by interest rates and energy products. In addition, I am pleased to see our European exchange is starting to expand from a small base. On April 10th, we traded 10,000 contracts for the first time with contributions from FX, European natural gas and cocoa.

- Turning to Swaps clearing, positive momentum continued in Q1 and we are very pleased to have a leadership position here. We continue to push on the innovation front. Relative to the other major global clearinghouses in rates - we were first with coupon blending, which offers capital and operational efficiencies in a capital and resource constrained world. This significantly reduces the number of transactions and the notional outstanding required to maintain a given portfolio. Already, customers have reduced over 100,000 line items and over $8 trillion in notional using this service. In addition, we are also working with TriOptima to offer multilateral compression for interest rate swaps for FCM house accounts.

- We were also first, logically so, with portfolio margining, facilitating individual client risk reduction by as much as 85 percent. Since the end of last year, the number of end clients utilizing this solution has more than doubled to 43 firms through 11 live clearing members. In December 2013, we expanded our offering to include clearing for the Mexican Peso swaps, making our IRS product scope the broadest available on any platform, with 18 currencies. We now have 37 clients voluntarily clearing these Mexican Peso swaps, including both dealer-to-dealer and dealer-to-client, and it is our fifth largest currency. All of these efforts have helped us to gain market share in plain Vanilla fixed vs. floating swaps in both dollar and non-dollar currencies.

- We continue to market our interest rate futures and options to over 500 CME OTC clearing customers. During the quarter, Greenwich Associates published a total transaction cost analysis comparing the costs of swaps vs. futures. Based on the detailed analytics from the 42 clients surveyed, it showed that futures are nearly always the lowest cost alternative. The Greenwich report is available on our website and we continue to educate market participants about this important comparison. Building on this, in March we launched a new web tool in conjunction with ICAP and the Beast Apps called RapidRV. This robust offering provides over 15 different analytics that allow customers to explore relative value and comparative pricing of swaps, cash Treasury markets and CME Group interest rate futures. With real-time pricing feeds, customers are able to view side-by-side pricing analysis and opportunity assessment across fixed income products.

- For some time now we have provided updates on statistics that we follow very closely that are potential signs of OTC clients using futures. Many of you have asked for additional data points on this transition. Last quarter, I mentioned our treasury futures business reached the highest proportion ever of the cash treasury business, at 75 percent of the size of the cash market. I am pleased to say in March, that number jumped to 77 percent. One new piece of data can be found in the slides. We have analyzed the activity of our top users of portfolio margining and we have seen futures trading growth rates almost twice that of the overall market place.

- The third area of growth I want to touch on is our options business. We eclipsed our prior peak options volume from Q4 to set a new quarterly volume record in Q1. This was driven by continued investment in our options trading functionality and bolstered by specific sales and marketing campaigns to draw new customers to our options markets. We saw double digit growth in interest rates, FX and agricultural products. Approximately 50 percent of our options business is traded electronically with about 40 percent traded on the floor and the remainder via privately negotiated transactions.

- In terms of our efforts to electronify options, we have made significant progress within Eurodollar options on Globex over the last year. The percentage of Eurodollar option volume traded on Globex has grown from 11 percent in 2013, to 13 percent in 2014, and almost to 20 percent in March and April of this year. This recent increase in electronic activity has been driven by growth from European participants trading in our overnight hours. In comparison, in our earnings slide deck you can see how the electronification of Treasury options, which are currently around 63 percent, has created meaningful growth. The reference slides illustrate the same trend across our other product lines as well. You can see the power of this transition – most significantly perhaps in FX options where their average daily volume is up 9-fold since 2009 powered by electronic trading. Additionally, we continue to successfully grow our Energy Options volumes on Globex, with 41% of our total Energy Options trading on Globex in Q1, up from just 28% in Q1 of last year. The point here is that options growth will drive activity in the futures markets too, since both these products are on the same platform and combination trades can be executed.

- So, overall we've had a nice start to the year. We continue to focus on ways to expand our business, while driving productivity improvements 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 with revenue up over 8 percent and expenses down 2 percent compared with Q1 last year, driving operating margins above 62 percent for the quarter, our best result in the last few years. Adjusted EPS came in at 98 cents, up 18 percent for the quarter compared to a strong Q1 last year. We saw nice performance in our core futures, OTC clearing and market data revenue.

- I'll start with some revenue details:

- The rate per contract for Q1 was 75.3 cents, up from 73.1 cents last quarter. The main driver of the increase was a shift in the product mix – with an increased proportion of total volume coming from higher-price commodity products. Specifically, we saw an approximate 2 percent shift from equity to energy products. Our transaction fee increase went into effect in February, and we have 2 months at the higher level in our first-quarter RPC.

- OTC swaps revenue totaled $20 million for the quarter, up 53 percent versus Q1 last year. During the first quarter, we captured $129 per IRS cleared trade which is consistent with what we have seen in the past, but down from Q4. We cleared approximately 2,370 trades per day in Q1, the highest level we have seen so far.

- Market data revenue of $98 million was up 10 percent versus Q1 last year, driven primarily by the elimination of our fee waiver program, which we have discussed the last few quarters. As a reminder, we began charging $42.50 per month for professional traders who were grandfathered, and we also capture $6 per month on average per screen for non-professional traders. In Q1, we accrued for approximately 150,000 new screens, with approximately 1/3rd of those at the higher professional level, and 2/3rd came in as non-professionals. It will likely take a few quarters to get to a steady state in terms of market data revenue, and we may see a drop from the $98 million level this quarter as customers settle into the new pricing structure.

- Adjusted expenses in Q1 were $317M, down $8 million from Q1 last year. We are very focused on driving efficiency throughout the organization, and eliminating redundancy to improve agility and customer responsiveness. Virtually every expense category came down with the exception of technology services and volume-related license fees. At the same time, we continue to roll out a significant number of new offerings which Gill outlined.

- At the end of Q1, we had 2,670 employees, down about 15 people from year end, and down 90 relative to this point last year driven by our October restructuring. Our compensation ratio for the quarter was 15.9 percent, down from more than 17 percent the last two years.

- Turning to taxes, the effective rate for the quarter was 36.6 percent.

- And now to the balance sheet – at the end of the quarter, we had nearly $1.8 billion in cash, restricted cash and marketable securities. During the quarter we issued a 10-year bond totaling $750 million at 3 percent, replacing debt that was going to mature in 2018. We also upsized our revolving credit facility from $1.75B to $2.25B. During Q1, our interest expense totaled $31 million, which was higher than Q4 primarily due to the double carry. We paid off the 2018 bond in April, and our quarterly run rate for interest expense will drop to approximately $29 million by the second half of the year.

- If we adjust for the bond transaction completed on April 8th, we had approximately $1.1 billion of total cash at the end of Q1. That leaves $400 million above the $700 million we target in terms of a minimum cash level. So far this year, we paid out over $800 million in total dividends.

- During the first quarter, capital expenditures, net of leasehold improvement allowances totaled $27 million dollars.

- In summary, the first quarter of 2015 demonstrated the leverage in our business model. The entire management team continues to focus on margin expansion with both top line growth and expense discipline.

- 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.

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. We want to caution you not to place undue reliance on any forward-looking statements. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. 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, implementation and maintenance of the enhanced functionality required by our customers while maintaining reliability and ensuring that such technology is not vulnerable to security risks; 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, including our ability to provide effective services to the swaps 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, including the impact of any changes in domestic and foreign laws or government policy with respect to our industry, such as any changes to regulations and policies that require increased financial and operational resources from us or our customers; the costs associated with protecting our intellectual property rights and our ability to operate our business without violating the intellectual property rights of others; decreases in revenue from our market data as a result of decreased demand; 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, 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.