Q1'13 Earnings Call Prepared Remarks
May 2, 2013

Gill

- Thank you for joining us today. I am going to highlight CME Group's first quarter and then turn it over to Jamie to review our financials.

- We experienced a solid start to the year. First quarter average daily volume was 12.5 million contracts, up significantly from the 10.5 million contracts averaged during the second half of last year. Open interest has jumped 18 percent year to date, up to 82.3 million contracts. Additionally, the first phase of the OTC clearing mandate was completed successfully with cleared volumes roughly double what they were prior to the mandate.

- Let me turn to the highlights of our core business. In the interest rate complex, we successfully grew volumes and open interest up from the levels that we saw in the second half of 2012. Treasury volume has been particularly strong to start the year, with first-quarter average daily volume of 3.4 million, up 24 percent compared to the same period last year. This included a treasury futures monthly record of 3.8 million contracts in February, up 33 percent over the prior February and we reached a daily all time high of 10.1 million contracts on February 26th. Additionally, we continued to successfully expand our Options business, with a record level of electronic trading of our 10-year Treasury Note Options of 54 percent, as well as generating 48 percent volume growth in our popular Weekly Treasury Options. Treasury options volume in February was the second highest month in our history. Overall interest rate average daily volume was 5.7 million contracts in the first quarter of 2013 compared to 4.3 million during the second half of 2012.

- Although the last two years have been challenging due to low volatility and low overall rates, we have invested in our interest rate complex through new product development to position it to strongly benefit once we come out of this difficult cycle. In the intermediate and long-term, we would expect that an improving economy, the end to quantitative easing, and increasing uncertainty around both the long and short ends of the curve, are large positives for the franchise. This product line also stands to benefit from the migration of non-cleared OTC interest rate swaps into clearinghouses, and potentially, substitution of futures contracts for some of those OTC products. And CME Group's value proposition is significantly enhanced with the introduction of portfolio margining for both House and Client accounts, creating powerful capital efficiencies for our global customer base.

- Looking at OTC, as I mentioned earlier, there has been a nice pick up in volume since wave one of the CFTC clearing mandate kicked in on March 11th, the first of a series of important dates for the industry. Since then, we have averaged \$20 billion per day, which is nearly double the amount we cleared from the beginning of the year leading up to the mandate. Interest rate swap open interest has also grown 44 percent to \$1.4 trillion since the beginning of the mandate. Recently, 270 buy side firms have registered with CME for OTC clearing and we are working closely with hundreds of firms and many intermediaries preparing for phase 2 that begins on June 10th. We continue to work to build liquidity in the deliverable swap futures contract, and we have 35,000 of open interest and several thousand contracts traded per day mainly by hedge funds, assets managers, mortgage servicers and banks. Right now, along with our FCM's and end customers, we are focused on onboarding for phase 2 of the mandate. Post June we expect an increased focus on our entire suite of rates offerings including core futures, the DSF product, as well as cleared swaps.

- During March, we successfully completed the first customer portfolio margining between cleared swaps and futures through one of our FCMs, and we expect 3 to 5 additional clearing members to provide this to end clients in a more scalable way later this quarter driven by client demand. The number of intermediaries automating this process should increase throughout the year. Our sales force is increasingly hearing about the importance of capital efficiencies, and our IRS product suite offers the best opportunity to optimize deployed capital, leveraging our existing deep open interest across the U.S. yield curve.

- We also continue to launch new products and product extensions for OTC clearing. During the first quarter, we launched interest rate swaps clearing through our European clearinghouse, and in the second quarter, we anticipate extending our OIS product out to 30 years, adding 3 new currencies, as well as launching amortizers based on customer demand.

- Turning to FX, this complex continues to perform exceptionally well driven by strength in our Japanese Yen and British Pound contracts, as well as significant year-to-date growth in our Emerging Markets FX products. First-quarter 2013 ADV was 1 million contracts, up 19 percent year-over-year. It is important to note we saw particular strength in terms of trading from Europe and Asia during Q1. Volume in FX trading during Q1 from Asia grew 60 percent while activity coming from Europe was 21 percent higher. This speaks to the continued FX market share gains we are achieving globally. FX options also continue to be strong, up 70 percent in Q1 versus the same period last year.

- In terms of FX open interest, we experienced record levels in March of 2.6 million contracts. Since the beginning of the year, our FX open interest is up 13 percent. In addition, we achieved a new record of 929 Large Open Interest Holders in Q1, up from 400 in 2009. This indicates that more customers are holding increasing amounts of FX risk at CME Group.

- Equities have also performed well, and have significantly outperformed our peer. Q1 2013 ADV was 2.6 million, up 9 percent year-over-year. Growth was supported by net inflows through March of $135 billion into equity funds as well as an increase in the VIX midway thru the quarter which contributed to strong volumes in February, up 22 percent, March, up 13 percent, and April, up 16 percent. E-mini options were up 86 percent in Q1 2013 versus last year, and up 88 percent in April 2013 supported by expanded participation in our weekly and monthly options. Also, in the quarter, volume in our Nikkei based products was up 76 percent in our yen contract and 116 percent in our dollar contract. In addition, open interest is up 23 percent year-to-date.

- Our metals complex has also benefitted from recent volatility. This has driven all-time record April 2013 ADV of 532 thousand, surpassing the last high in August 2011. We also hit multiple records on April 15, 2013 which included combined futures and options trading of 1.5 million contracts, 78 percent above the prior record, and we set all time trading records in gold futures, gold options, and copper futures.

- Turning to agricultural commodities, the Kansas City Board of Trade integration is going well and volume in that product was up 24 percent in Q1 versus first-quarter last year, and up 21 percent from the fourth quarter. Going forward, we are excited about the opportunity to leverage our leadership position in this category around the globe, especially in Asia.

- Lastly, I will touch on our energy complex. April was a very a strong month with ADV of 1.9 million, up 20 percent versus the same period last year driven by increased volatility, rising natural gas prices and ongoing corrections to infrastructure issues. In April, crude, natural gas, and power were up significantly compared to the first quarter. In recent weeks, the WTI and Brent spread has tightened considerably to under $9 in the June contract and the Seaway pipeline boost of daily activity will continue to be helpful. Longer term, significant U.S. production should help the WTI and our refined and natural gas products, with an increased focus on energy independence and the potential for exports. In the meantime, we are also focused on expanding global solutions through our DME and Brent product offerings to grow our presence in key areas such as Europe and Asia.

- One final note, we had record total volume and revenue from Asia during the first quarter. We saw 24 percent volume growth in Q1 compared to the prior first quarter, and ADV totaled approximately 440 thousand contracts per day. Transaction fee revenue from the region grew 31 percent compared to the prior year. During the quarter, all six product areas grew, with particular strength in Ags, FX and equity products.

- In summary, we remain the only major pure play derivatives exchange with the widest range of benchmark products covering all major asset classes. We continue to build on this by investing aggressively in our global growth strategy, which includes launching new products and product extensions, expanding our global footprint through further development of infrastructure and partnerships, as well as enhancing our worldwide sales force leading to unparalleled distribution of our products and better insight into customer needs. All of this, coupled with a strong expense discipline, equates to significant cash flow generation. This has led to a consistently strong return of capital strategy to reward our shareholders while continuing investing in the future growth of the company.

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

Jamie

- Thank you Gill and good morning everyone. I'd like to walk you through the detailed results for Q1.

- From a financial perspective, we had a nice quarter. Despite 4 fewer trading days compared to last quarter, our revenue jumped approximately $58 million, and our adjusted expense was only $7 million higher, resulting in incremental margins above 85 percent. Please take note that excluding the foreign currency fluctuation losses mentioned in the release, our earnings per share would have been 73 cents, up over 15 percent versus Q4 adjusted EPS.

- Let me start the Q1 discussion with revenue –

- The rate per contract for the first quarter was 78.5 cents, down 6 percent sequentially. The largest driver was product mix. While we saw volume increases across all of the product lines, lower average fee products like our interest rate contracts saw faster volume growth than higher fee agricultural and energy contracts. Another driver of the lower average rate in Q1 was member-nonmember mix, as member volumes grew faster than non-member volumes, and we saw an impact based on energy-related incentives.

- First-quarter Other Revenue was $23 million, up from $14 million in Q4, due primarily to a progress payment from BM&FBOVESPA related to our trading platform co-development.

- Moving on, total first-quarter operating expense was $301 million, excluding the previously mentioned FX impact.

- Breaking down operating expense in more detail, Compensation and Benefits was $129 million, up $16 million sequentially. This included $10 million of timing related items that tend to impact Q1 more severely than other quarters. Examples include our vacation accrual that will reverse out later in the year as folks take their annual vacations, and other employment taxes that are subject to caps that get hit earlier in the year. In addition, deferred compensation expense was $2 million higher than the prior quarter as the US equity market was strong in Q1; remember this is also recognized as interest income below the line, so has a net zero impact on our bottom line. Finally, our bonus was up $4 million sequentially, based on better performance versus our targets.

- Headcount at the end of the quarter was approximately 2,615, up 50 during the quarter including the KCBT employees, continued hiring in our Northern Ireland Office to replace consultants and hires in growth areas like Clearing and Sales.

- Overall, our teams have been very focused on being as efficient as we can on the cost front. Looking at non-compensation expense, each line item was flat to down with the exception of license fees due to growth in both equity and CME ClearPort volumes.

- Turning to non-operating income, we did not record a dividend this quarter from BVMF. We record dividends on the ex-dividend date, and the ex-date for their Q1 dividend fell in April this year. Based on what they declared, our portion will be approximately $10 million. We will recognize this dividend in Q2, and depending on their timing, we may end up recording two dividends from them in Q2. If we had been able to record this dividend in Q1, our Q1 EPS would have been a couple of cents higher.

- Turning to Interest expense, this item totaled $39 million in Q1 which we guided to last quarter. We will be paying down our upcoming August maturity and will likely look to issue new debt later this year to prefund the February 2014 bonds. Once we've worked through these near-term maturities, our run rate quarterly interest expense will likely be between $26 and $27 million starting in Q2 2014.

- Equity in gains in unconsolidated subsidiaries was $17.5 million, with good results from the S&P Dow Jones joint venture. In April, the company purchased the non-controlling interest in CME Group Index Services LLC (Index Services) for $80.0 million. Index Services had maintained a 24.4 percent interest in S&P/Dow Jones Indices LLC (S&P/DJI). As a result of the purchase of the non-controlling interest, our share in the JV increased to 27 percent. We were also pleased with the recent extension of the long term agreement between the JV and CBOE, which should favorably impact the JV's results beginning this year.

- Turning to taxes, the pro-forma effective tax rate, excluding the FX impact, was approximately 38.5 percent.

- On the balance sheet, we had $1.9 billion of cash and marketable securities, up approximately $240 million during Q1, and capital expenditures net of leasehold improvement allowances totaled $19 million in the first quarter, driven by technology spending.

- In terms of guidance, our 2013 expense projection of $1.25 billion remains unchanged based on the expected timing of some growth oriented investments later this year. In addition, our CAPEX guidance remains between $140 and $150 million.

- April average daily volume, so far, has been good relative to Q1. Over the last 5 years on average, ADV has fallen 12 percent in April compared to the first quarter. This April, we were down 7 percent, and the decline is skewed to the product lines with lower average rates. In addition, as footnoted in our release, please note that first-quarter average daily volume and RPC figures do not include the KCBT volume, but the $2.3M of transaction revenue generated is included in the first-quarter clearing and transaction fee revenue on the income statement. The KCBT volume has been reported within the overall CME Group volume as of April 1st.

- In summary, we continue to focus on investing for the future; in particular we have positioned ourselves to fully take advantage of the changing regulatory and competitive landscape as well as the medium-term favorable cyclical trends. As always, while investing in our future, we also remain intensely focused on generating excess capital and returning it to our shareholders.

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

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