CME Group 2Q 2023 Earnings Introductory Script

July 26, 2023

Adam Minick

Good morning, and I hope you are all doing well today. We will be discussing CME Group’s second-quarter 2023 financial results. I will start with the safe harbor language, then I'll turn it over to Terry.

Statements made on this call and in the other reference documents on our website that are not historical facts are forward-looking statements. These statements are not guarantees of future performance. They 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 statement. Detailed information about factors that may affect our performance can be found in the filings with the SEC, which are on our website. Lastly, on the final page of the earnings release, you will see a reconciliation between GAAP and non-GAAP measures.

With that, I’ll turn the call over to Terry.

Terrence A. Duffy

Thank you all for joining us this morning.

We released our executive commentary earlier today, which provides details on the second quarter of 2023. I will make a few brief comments on the quarter and current outlook, and Lynne will summarize our financial results. In addition to Lynne, we have other members of our Management Team present to answer questions after the prepared remarks.

As we mentioned last quarter, 2023 is setting up to be an extremely favorable backdrop for risk management. The continued geopolitical uncertainty, and the increasing cost of capital for businesses, are just a couple of the things that helped us deliver our financial results for the quarter.

The benefit of CME Group's diverse product portfolio spanning six asset classes was on display. ADV across our commodities asset classes increased 20%, with 34% growth in Agricultural products, 27% growth in Metals and 9% in Energy. Interest Rates ADV of 11.3 million was up 6% for the quarter and is up 11% compared with the first half of 2022.

Despite a substantial decline in equity market volatility, our Equity asset class delivered ADV of 6.2 million contracts during Q2.

Our non-U.S. ADV was 6.3 million contracts for the quarter, including double-digit year-over-year growth in Ags, Metals and Energy.

Options again played a critical role in Q2, with ADV growth of 20% to 4.7 million contracts including the highest quarterly Agricultural options ADV on record, up 32% from Q2 last year.

Our product innovation in this area has driven strong growth with new participants and more product choice to more precisely match risk, as clients continue to look for ways to protect their portfolios in these uncertain times.

As it relates to our rates market, expectations of short-term rate changes up or down, and divergent economic data, continue to drive risk management. As we saw with the recent resolution of the debt ceiling, the Treasury bill issuance increased dramatically.

Over time, we expect that more coupon issuance and ongoing debt financing will contribute to greater hedging needs for years to come.

On the Commodities side, exports are increasing the demand for risk management using our benchmark agricultural and energy products. With this favorable backdrop, we will continue to focus on opportunities to accelerate growth, including our recent announcement with DTCC to increase cross-margining opportunities for the Treasury markets. Additionally, our ongoing focus on product innovation and data services continues to enhance trading opportunities for our clients.

We believe the strong underlying environment combined with our strategic execution across growth initiatives positions us for accelerated growth in coming years.

With that, I'll turn it over to Lynne to cover the second quarter financial results.

Lynne Fitzpatrick

Thanks Terry.

During the second quarter, CME Group generated $1.4 billion in revenue, up about 10% compared with a strong second-quarter last year. Clearing and Transaction fees grew over 9% while Market Data revenue increased 8% versus Q2 2022.

Expenses on an adjusted basis were $452 million for the quarter and flat with the first quarter at $374 million, excluding license fees. This quarter our investment in our cloud migration was approximately $15 million. Our adjusted operating margin for the quarter expanded to 66.8%, up over 250 basis points compared to the same period last year.

CME Group had an adjusted effective tax rate of 23.3%, which resulted in adjusted net income of $836 million driving diluted earnings per share of $2.30, both up 17 percent from the second quarter last year. In addition to our expanding margins, the strength of our operating model was evident this quarter as we delivered an increase of approximately $120 million in both revenue and adjusted net income compared to last year.

Capital expenditures were approximately $22 million and CME Group paid dividends during the quarter of $400 million. Our ending cash balance was approximately $2.0 billion.

As you can see with the current results, the entire team at CME Group is focused on growing the business. We have delivered double-digit adjusted earnings growth in each of the last 8 quarters. Although it is challenging to predict volumes or market conditions over the short term, when you look at the last 5, 7 or 10-year period we have grown our earnings by a compound annual growth rate of 10-12% per year despite multiple periods of zero interest rate policy and the impacts of the pandemic on the global economy. As Terry mentioned, we are in a favorable environment for risk management products and we're taking a number of actions designed to accelerate our growth going forward through customer expansion, new product and service innovation and enhancing capital efficiencies. Given this, our goal as a Management Team is to deliver growth in the coming decade above these historical averages.

Terry, I'll hand the call back to you.

Terrence A. Duffy

Thanks Lynne. We are very pleased with the continued strong financial performance of the company. Before opening the call for questions I'd like to ask Tim and Derek to comment briefly on the recent trends we've seen in our short-dated options products.

Tim McCourt

Thanks Terry.

We are very pleased with the performance of our equity options on futures, which year-to-date drove 1.3M contracts per day. Short-dated options, including zero days to expiry or 0DTE options remain a strong driver of our multi-year growth. Volume in our same day expiring options is up 33% from last year and 220% since 2021 and now make up 27% of our equity options volume. Also, we are seeing volume and open interest growing across the entire maturity curve. Year-to-date equity options are up 6% compared to a record year in 2022 with particular strength in Nasdaq options and Russell 2000 options both up double-digits.

This strong growth story further demonstrates the value customers continue to derive from trading products on the most important equity indices at CME Group. While short-dated options have been largely an equities story to date, we're starting to see expansion to other parts of the portfolio, which Derek will talk about now.

Derek Sammann

Thank you, Tim.

As we've discussed in recent quarters, options have become a bigger part of global customers' risk management and trading strategies. Year to date, average daily volume in our Options franchise across all asset classes is up 26% driven by Interest Rates, Metals and Equities, and our non-US options business is up 33% through June.

Within this larger growth story, we have seen growing demand for weekly options expirations across our asset classes, with weekly options volume up 21% year-to-date and growing to 26% of total options trading.

In addition to equities, commodities traders have similarly embraced shorter-term expirations which allow our global customers to hedge specific event risks, such as crop reports and OPEC meetings. Agricultural weekly options were up 168% in Q2, which contributed to a record quarter for Agricultural options overall. In Energy, our WTI weekly options grew 126% versus second quarter last year while our gold weekly options are up 33% year-over-year.

The strength of our options franchise allows CME Group to uniquely deliver significant capital and operational efficiencies and meets our customers' need for short-dated options to help them most effectively manage risk across their entire portfolio.

We can now open the call for questions.

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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; our ability to adjust our fixed costs and expenses if our revenues decline; our ability to maintain existing customers at substantially similar trading levels, develop strategic relationships and attract new customers; our ability to expand and globally offer our products and services; changes in regulations, including the impact of any changes in laws or government policies with respect to our products or services or 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 or changes to regulations in various jurisdictions; 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 credit and liquidity risk management practices to adequately protect us from the credit risks of clearing members and other counterparties, and to satisfy the margin and liquidity requirements associated with the BrokerTec matched principal business; 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; our dependence on third-party providers and exposure to risk through third parties, including risks related to the performance, reliability and security of technology used by our third-party providers and third party providers that our clients rely on; volatility in commodity, equity and fixed income prices, and price volatility of financial benchmarks and instruments such as interest rates, credit spreads, equity indices, fixed income instruments and foreign exchange rates; economic, social, 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; the impact of the COVID-19 pandemic and response by governments and other third parties; 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, control the costs and achieve the synergies associated with our strategy for acquisitions, investments and alliances, including those associated with the performance of our joint ventures with S&P Dow Jones (S&P Dow Jones Indices LL) in index services and in trade processing/post trade services (OSTTRA), our primary data distribution partners' actions and our partnership with Google Cloud; variances in earnings on cash accounts and collateral that our clearing house holds for its clients; impact of CME Group pricing and incentive changes; impact of aggregation services and internalization on trade flow and volumes; any negative financial impacts from changes to the terms of intellectual property and index rights; uncertainty related to the adoption and growth of SOFR and its impact on our business; our ability to continue to generate funds and/or manage our indebtedness to allow us to continue to invest in our business; industry, channel partner and customer consolidation; decreases in trading and clearing activity; the imposition of a transaction tax or user fee on futures and options transactions and/or repeal of the 60/40 tax treatment of such transactions; our ability to maintain our brand and reputation; and the unfavorable resolution of material legal proceedings. For a detailed discussion and additional information concerning these and other factors that might affect our performance, see our other recent periodic filings, including our Annual Report on Form 10-K for the year ended December 31, 2022 as filed with the Securities and Exchange Commission ("SEC") on February 27, 2023, under the caption "Risk Factors".