CME Group 3Q 2022 Earnings Introductory Script

John C. Peschier

Good morning, and I hope you are all doing well today. I'm going to start with the safe harbor language, then I'll turn it over to Terry and team for brief remarks followed by your questions. Other members of our management team will also participate in the Q&A session.

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.

On a personal note, today will be my last earnings call as I am retiring after more than 20 years with CME. My first day on the job was December 24th of 2001 with the plan that CME would go public soon after I joined. CME ultimately went public in December 2002, and it has been an amazing run and we have created a lot of value for our investors. I want to thank all of our shareholders and sell side analysts who I have met on this journey.

Also, I want to thank all my CME colleagues I have worked closely with during the last two decades. In particular, the CFO's – Dave, Jamie, and John. Most importantly, Jennifer George and Susan Jacks with whom I have worked with closely for many years and have been instrumental to the success of our investor relations program.

Lastly, I'd like to thank Terry for his leadership of this successful journey. He and I are the only ones left who were on the first CME earnings call in 2003 and it's been a great run. With that, I wish you all well and I'll turn the call over to Terry.

Terrence A. Duffy

Thank you all for joining us this morning.

Let me take a quick moment first to thank you, John, on behalf of all of us, for an incredible run – more than two decades of service with CME Group.

You have been an instrumental force in our investor and analyst outreach, helping us grow from our early days as a public company to the leading derivatives marketplace we have become today. As a friend and respected colleague to so many, you've made a significant impact on our business. There is no doubt that you will be missed. We wish you nothing but the best for you and your family going forward.

We are leaving the investing community in good hands with the remaining members of the Investor Relations team, Jennifer George and Susan Jacks, who have worked side by side with John throughout his entire career here, as well as Adam Minick, who recently joined the IR Department, moving over from our Strategy department.

We released our executive commentary earlier today, which provided extensive details on the third quarter of 2022. I have John, Lynne, Sean, Derek, Sunil and Julie Winkler on the call this morning, as well as Tim McCourt, our Global Head of Equity and FX Products. I felt it was important to take some time to not only run through a snapshot of our current business and financial results, but more importantly, to expand on why we feel our business is in such a strong position to finish out the year and head into 2023 on a high note.

I will start, and Sean, Tim and Derek will provide some thoughts before John finishes up our commentary with details related to our financial results. Then we will then open the call for your questions.

Let me start by talking about the tremendous amount of uncertainty in the markets today – whether that be uncertainty around the US Federal Reserve's policy, varying views about recession risk with inflation at levels not seen since the 1980s, or uncertainty around the size and speed of the unwind of the Fed's balance sheet. When there is uncertainty driving activity in our Interest Rates business, the impacts cascade to other asset classes:

- most prominently in Equities, as rate changes impact corporate valuations, and
- in Foreign Exchange, with varied policies and approaches from central banks around the world.

We are also seeing high levels of volatility in the commodities markets which appear likely to persist given the impact of the Russian invasion in the Ukraine and the resulting disruptive affects to both agricultural and energy markets in the region, and around the world.

Risk management is our business, and we have been, and always will be, committed to helping our customers manage uncertainty. We do this across our unique breadth of asset classes and our broad range of deeply liquid, globally relevant products.

With that being said, let me transition into our Q3 performance…Our performance in Q3 and year-to-date in 2022 highlights the effectiveness of our risk management solutions. Our volume is up 23% year-to-date versus the same period last year, and up 19% from the same period in 2019, prior to the pandemic. The highest average daily volume quarter in CME Group's history was Q1 of 2020 when risk management was critical at the onset of the pandemic. The first three quarters of this year have been the second, third and fourth highest ADV quarters in our history.

So far, in 2022, our Interest Rates, Equities and FX products have hit peak levels of large open interest holders, with our Interest Rate products at an all-time high again, just last week, suggesting that this represents a 'risk on' environment. Additionally, Q3 represented our 5th sequential quarter of double-digit year-over-year growth in total ADV.

With the pandemic becoming part of our lives, global economies and market participants are left to manage not only uncertain market risks, but also potentially new risks associated with the pandemic.

We're pleased the NEX integration is complete and market participants are able to access cash treasuries and cash foreign exchange through one platform, complementing our existing futures on treasuries and on foreign exchange.

The breadth of the assets we've built over time, combined with the work we are currently doing in partnership with Google to transform markets, will provide us further opportunity to continue our industry-leading innovation going forward – and we are 100% focused on growing in the short-term while also positioning the business for longer-term sustained growth.

I'll now turn it over to Sean, and then Tim and Derek, to dig into more detail around these themes.

Sean Tully

Thanks, Terry. With a return of interest rate volatility and central bank activity, we've seen strong year-over-year growth in our fixed income businesses. Interest Rate futures and options ADV were up 28% in Q3, and we've now delivered 6 consecutive double-digit year-over-year ADV growth quarters for the asset class.

The tailwinds Terry described should continue moving into 2023. Every FOMC meeting is in play and with high and uncertain inflation, every jobs report and every Consumer Price Index reading is important. You could see this very clearly with 34 million contracts trading in a single day on October 13th, following the last CPI release – and the uncertainty here could remain for years, as inflation readings for rent and shelter tend to lag the real economy by up to 18 months.

These factors have led to significant trading volumes in our short-term interest rate complex with volumes up 45% through the first three quarters. During this time, we have progressed the Eurodollar to SOFR migration with SOFR futures and options both now trading more contracts per day than their Eurodollar counterparts reaching a record 5.9 million SOFR contracts traded on October 13th. Lastly, our ARRC endorsed Term SOFR benchmark has already been licensed to over 1,700 firms in 83 countries and has been referenced in over $2.8 trillion in loans and OTC derivatives.

On the long end of the curve, we saw double-digit ADV growth in both Q2 and Q3, in Treasury futures, and Treasury options have had particular strength recently with 21% growth in Q3. The tailwinds from Fed balance sheet reduction and inflation are becoming larger, and have the potential to be long lasting due to the huge increase in government debt. And, as Terry mentioned, uncertainty in monetary policy then drives uncertainty in other asset prices.

I'll turn it over to Tim, to speak to this very point.

Tim McCourt

Thanks, Sean, and it is a pleasure to be on the call today.

Starting with the strength of our Equity Index business, where our deep, and liquid markets offer access to the most important global benchmark indices on one platform around the clock. This strong foundation positioned us well in 2022 as interest rate expectations have led to equity valuation adjustments and an increased need for risk management. The first three quarters of this year were the first, second and third highest ADV quarters on record respectively, both for overall Equity Index ADV and for Equity Index options ADV. Year-to-date through Q3, total ADV increased 44% and options ADV increased 74% compared with the same timeframe last year. Our growth is driven not only by volatility but also by product innovation.

One of our most successful innovations was the launch of our Micro E-mini products in 2019. We view the Micros as a useful tool to continue to attract new international and US-based customers given the smaller contract size and lower upfront financial commitment. Due to the premium price point on a risk equivalent basis, the 3.2 million micro equity contracts per day added the revenue equivalent of approximately 1 million E-mini contracts, despite being 1/10 the notional size.

We have also introduced a suite of products that bring traditional OTC functionality to CME such as Basis Trade at Index Close, Adjusted Interest Rate Total Return Futures, Sector Futures, Dividend Futures, Equity Option blocks and most recently Derived Block functionality. These OTC alternative products meet customer's needs under the uncleared margin rules while benefiting from the capital efficiency afforded by our equities franchise. These premium products command fees of 3 to 4 times the standard equity rates and added approximately 160 thousand contracts per day in Q3.

Now I will turn to FX, which has certainly come alive following an extended period of historic low volatility with 3Q FX ADV up 41% year-over-year.

Similar to Equities, we introduced innovations in our FX business during the low-volatility period and are now harvesting those investments. We changed minimum price increments, built out emerging market currencies and OTC alternative products like FX Link, added EBS cash markets, and created tools and analytics that show the efficiencies of trading FX at CME. These innovations position us well to continue to benefit from the volatility in the currency markets as global central bank disparate interest rate approaches continue to flow through the FX rates.

Derek will now address the trends in our commodities, options, and international businesses.

Derek Sammann

Thanks, Tim.

While our Energy business, which has been impacted by temporary market dislocations, was the only asset class that was down in Q3, we like the long-term structural positives for our US-based Energy benchmarks including WTI Crude Oil, Refined Products, and Henry Hub Natural Gas.

The US is producing nearly 12 million barrels of oil a day and exporting record levels of Crude and Refined Products. The US is the marginal supplier of Crude Oil to Europe and Asia which positions WTI and our refined product benchmarks well for the long term, beyond the current supply and price dislocations. Similarly, the US is the world's largest producer and exporter of Natural Gas, boosted by increasing Liquified Natural Gas exports priced off our Henry Hub futures market. Additional LNG facilities are coming online in the US in the medium term, which further bolsters Henry Hub as the benchmark for the global Natural Gas market for decades to come.

As the market transitions through the short-term disruptions caused by the war in Ukraine, we believe that we have the strongest portfolio of risk management tools in the global Energy and Environmental Products markets which positions us well to grow this asset class over the long term.

In Agricultural products, CME's markets serve as the benchmarks for global price discovery for grains, oilseeds, livestock, dairy and lumber. We saw increased customer activity in the third quarter with average daily volume of 1.2M, which was up 6% year-over-year, with particular strength in options. Buy Side and Bank customers are our strongest performing client segments this year, and our strongest global growth is coming from Latin America.

Turning to Metals, Q3 average daily volume increased 4% to 498,000, led by 20% growth in September. CME Group's Aluminum futures continue to see strong adoption by both commercial and financial market participants. Given the customer growth we are seeing, the adoption of COMEX Aluminum by the top meals broker Marex, and the success we've had in getting our reference prices to be included in physical procurement contracts from commercial customers, we feel that we are at an inflection point for growth in this important market.

Turning to options, we continue to see Options ADV and Open Interest outpacing Futures. Terry spoke earlier about the high levels of uncertainty in the world today, and options are a powerful tool for helping our global customers to manage risk in that environment, and can be a more cost-effective means of getting exposure since only the option premium is funded. With year-to-date Options ADV up 27% to 4.1 million, we are on track to surpass our record year in 2019 of 4 million.

Finally, our international business continues to generate record volumes. In Q3 we delivered 6.1 million ADV, up 21% versus last year. Based on our strong year to date results, we are on track to deliver another record year, with our non-US ADV through September of 6.5 million compared to our record 5.5 million ADV from last year.

With that, I'll turn it over to John.

John Pietrowicz

Thanks, Derek.

CME's revenue for the third quarter was approximately $1.23 billion driven by a 26.1% growth in trading activity. This was up 10.6% compared to the third quarter of last year and up nearly 15 percent when adjusting for the impacts of the formation of OSTTRA, our post trade joint venture with S&P Global that we formed in September of last year. This is our fourth consecutive quarter, when making that adjustment, of double-digit revenue growth demonstrating the importance of our markets in these uncertain times.

Market Data revenue was again a record during the quarter, up 6 percent compared to a year ago to $154 million reflecting the strong need for the information our markets produce.

Expenses continue to be very carefully managed and on an adjusted basis were $441 million for the quarter and $359 million excluding license fees.

Our efforts toward moving to the cloud progressed as expected and we are nearing the completion of the initial foundational work necessary to migrate our applications. Year-to-date we have spent approximately $21 million in incremental cash costs towards that effort and expect to end the year at approximately $30 million and within our first-year guidance for that project.

On a year-to-date adjusted basis, excluding our Google spend, license fees and the impacts of the formation of OSTTRA, our revenues were up 13% and our expenses were up only 3%.

We continue to manage our capital expenditures effectively and with an eye towards our move to the cloud. As a result, we are lowering our capex guidance to $100 million. For the quarter, our capital expenditures were approximately $20 million.

Our joint ventures and investments continue to produce meaningful results for CME Group. Year-to-date, on an adjusted basis, these investments have contributed $272.5 million or close to 10% of our pretax income this year. In addition to the earnings they contribute, their strategic importance continues to play out. The OSTTRA joint venture is capturing synergies through the combination of our post-trade businesses with that of S&P Global. This creates the leader in the space and has the scope and scale for long-term growth. Our S&P Dow Jones Indices Joint Venture has delivered 14% average annual earnings growth since the first full year of inception in 2013. Strategically, the exclusive rights to the indices that we have secured through our ownership of the joint venture underpins over 20% of the overall futures contracts traded at CME Group and creates significant capital efficiencies across our Equity complex making us the global destination for equity futures. We also benefit from the trading of products licensed by the joint venture to other exchanges and from the continued move from active to passive investing. These joint ventures and other investments that we have made continue to position CME well strategically and financially.

For the quarter, CME had an adjusted effective tax rate of 23.4 percent, which resulted in an adjusted net income of $719 million, up 25 percent from the third quarter last year, and an adjusted EPS attributable to common shareholders of $1.98.

CME paid out nearly $2.3 billion of dividends so far this year and cash at the end of the quarter was approximately $2.2 billion.

In summary, our global benchmarks, data, innovation, investments, and strong focus on execution continue to address the needs of our clients and deliver results for our shareholders.

Please refer to the last page of our Executive Commentary for additional financial highlights and details.

We'd like to now open up the call for your questions. Based on the number of analysts covering us, please limit yourself to one question, and then feel free to jump back into the queue. Thank you.

Statements in this press release 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 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 programs 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; 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 our investment in S&P/Dow Jones Indices LLC (S&P/DJI), our OSTTRA joint venture with IHS Markit (now a part of S&P Global) and our partnership with Google Cloud; uncertainty related to the transition from LIBOR;; 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 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, 2021, as filed with the Securities and Exchange Commission ("SEC") on February 25, 2022, under the caption "Risk Factors".