CME Group 4Q 2022 Earnings Introductory Script

<u>Adam Minick</u>

Good morning, and I hope you are all doing well today. We will be discussing CME Group's fourth-quarter and full-year 2022 financial results. I will 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.

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 provided extensive details on the fourth quarter of 2022. I am going to start with just a few high-level comments regarding the year, and then John will summarize our financial results and Lynne will speak to our expense guidance for 2023. In addition to John and Lynne, we have other members of our management team present to answer questions after the prepared remarks.

2022 was the best year in CME Group's history, with record average daily volume of 23.3 million contracts, up 19 percent from 2021. The growth was led by our financials products, which finished the year up 25 percent to a record ADV of 19.5 million contracts. Options average daily volume across all asset classes also set a record with ADV of 4.1 million contracts, up 23 percent versus last year. And finally, our non-U.S. ADV increased to a record 6.3 million contracts.

Throughout 2022 we continued our efforts on the LIBOR transition. We collaborated with the industry and market participants to shift trading behavior, order flow, and open interest to SOFR, and as a result we are beginning 2023 with SOFR futures and options as the leading tools for hedging short-term interest rates, with deep liquidity supporting a wide range of strategies across the forward curve.

Customer demand continued to drive our industry-leading product and services innovation throughout the year. We enhanced our micro products suite with additional contracts, and - in aggregate - the micros contributed nearly 3.5 million contracts of ADV to the overall record activity.

During the year, we further invested in our S&P Dow Jones Indices joint venture to expand its offerings to include leading fixed income and credit indices. Our joint ventures and investments continue to produce meaningful results for CME Group. For 2022, on an adjusted basis, these investments have contributed nearly $350 million or 9 percent of our pretax income.

2022 was a foundational year for our Google partnership. We built out the Cloud platform and successfully migrated some early applications. 2023 will be about accelerating our application migration including launching data products in the Cloud. We have an aggressive migration plan for 2023 and look forward to reporting on our accomplishments throughout the year ahead.

Risk management will continue to be critical for our customers as we move into 2023, with a higher cost of doing business in general - and uncertainty persisting across all of our asset classes. We continue to focus on what we can control – innovating and offering market participants meaningful capital and operational efficiencies across a diverse and globally relevant product set. So far this year, volume is averaging approximately 23 million contracts per day - near the average for all of 2022, and our focus will continue to be on growing in the short term while also positioning the business for longer-term sustained growth.

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

John Pietrowicz

Thanks Terry.

Financially 2022 was a record year for CME Group with adjusted double-digit revenue and earnings growth. Driven by CME's record annual trading volume, 2022 revenues were $5.0 billion up 11 percent, when adjusting for OSTTRA, which was launched in September of 2021. Our annual adjusted expenses, excluding license fees, and before the impacts of our cloud migration, were approximately $1.425 billion which was $25 million below our annual guidance. Our adjusted operating margins for the year expanded to 64.7 percent and adjusted net income was up 20 percent.

For the year, our incremental cash costs associated with our migration to the cloud were $30 million dollars and in line with our expectations.

Turning to the fourth quarter, CME generated more than $1.2 billion in revenue with average daily volume up nearly 6.5 percent compared to the same period last year. Market Data revenue was up nearly 8 percent from last year to $153 million.

Expenses were very carefully managed and on an adjusted basis were $464 million for the quarter and $382 million excluding license fees and approximately $9 million in cloud migration costs.

CME had an adjusted effective tax rate of 22.8 percent, which resulted in an adjusted net income attributable to CME Group of $698 million, up 15 percent from the fourth quarter last year, and an adjusted EPS attributable to common shareholders of $1.92.

Capital expenditures for the fourth quarter were approximately $23 million. CME declared over $3 billion of dividends during 2022, including the annual variable dividend of $1.6 billion, and cash at the end of the quarter was approximately $2.8 billion.

Finally, in November, we announced fee adjustments which became effective February 1st. Assuming similar trading patterns as 2022, the fee adjustments would increase futures and options transaction revenue in the range of 4 to 5 percent.

In summary, 2022 was the best year financially for CME Group. We served our customers well, successfully transitioned the majority of the volume of our LIBOR based benchmarks to SOFR, executed on our cloud migration strategy, all while managing our costs very effectively.

With that, I will turn over the call to Lynne to discuss CME Group's 2023 guidance.

Lynne Fitzpatrick

Thanks John.

We expect total adjusted operating expenses excluding license fees, to be approximately $1.49 billion for 2023. Our guidance reflects our continued focus on cost discipline which will moderate the impacts of inflation and a full year of normalized travel and in person events. In addition to our core expense guidance, we expect the investment related to the Google partnership and our cloud migration to be in the range of $60 million in expense offset by a $20 million decrease in capital expenditures bringing our incremental net cash costs for the migration to $40 million for the year.

Total capital expenditures, net of leasehold improvement allowances, are expected to be approximately $100 million, and the adjusted effective tax rate should come in between 23 percent and 24 percent.

We'd now like to 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.

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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, 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 the performance of our joint ventures with S&P Dow Jones (S&P Dow Jones Indices LLC) in index services and in trade processing/post trade services (OSTTRA), our primary data distribution partners' actions and our partnership with Google Cloud; volatility in our collateral income and non-cash collateral that we hold for clients; customer demand/elasticity/reaction to our pricing and incentive changes; impact of aggregation services and internalization of 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, 2021, as filed with the Securities and Exchange Commission ("SEC") on February 25, 2022, under the caption "Risk Factors".