Q407 Earnings Call Prepared Remarks
Feb 5, 2008

John

Thank you for joining us. Craig Donohue, our CEO, and Jamie Parisi, our CFO, will spend a few minutes outlining the highlights of 2007 and the fourth quarter, and then we will open up the call for your questions. Terry Duffy, our Executive Chairman, Phupinder Gill, our President, and Rick Redding, our head of products and services, have also joined us this morning and will participate in the Q&A session.

Before they begin, I'll read the safe harbor language. Statements made on this call, and in the accompanying slides on our Web site, 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. More detailed information about factors that may affect our performance may be found in our filings with the SEC, including our most recent Quarterly Report on Form 10-Q, which is available in the Investor Relations section of the CME Group Web site.

During this call, we will refer to GAAP and non-GAAP pro forma results. A reconciliation is available in our press release, and there is an accompanying file on the investor relations portion of our Web site that provides detailed quarterly information on a GAAP and Pro forma basis.

Now, I would like to turn the call over to Craig.

Craig

- Thank you for joining us this morning. In many ways 2007 was a transformative year for CME Group. Not only did we complete our historic merger with the Chicago Board of Trade, but we also delivered tremendous growth and financial results in our core business, and positioned our company for the future.

- Total combined trading volume of 2.8 billion contracts grew by more than 29 percent compared with the prior year, with strong performance in every product line. We delivered our seventh consecutive year of volume growth above 20 percent. Our solid performance reflects our continuing efforts to expand our customer base, improve the speed and functionality of our systems, and develop innovative new products and markets.

- We certainly proved we could multitask in 2007. In addition to our volume growth, we continued to execute on our growth initiatives. Hosted by our CME Globex electronic platform, NYMEX energy and metals product volume more than tripled from 2006 to 2007, averaging 760,000 contracts per day. Fourth-quarter average daily volume rose 130 percent, representing the sixth consecutive quarter of record volume. We continued to deliver innovative products during 2007, including contracts based on the MSCI Emerging Markets index, the E-mini S&P Small Cap 600 index, and the Lehman Brothers Aggregate Bond Index, as well as new commercial real estate and weather contracts. Additionally, we announced plans to launch volatility quoted options in our FX product line beginning in March of 2008. Volatility-based quoting is the quoting convention most commonly used in the over-the-counter (OTC) FX market.

- As a result of our efforts, we delivered outstanding financial results during 2007. For 2006, I was proud to report record stand alone financial results with $1.1 billion of revenue and net income of $407 million. In 2007, on a combined basis our revenue and net income virtually doubled to $2.1 billion and $817 million, respectively.

- As we turn to 2008, we have many reasons to be enthusiastic about the opportunity at hand. First, the integration to date of the CME and CBOT has been smooth, and our customers and shareholders are now seeing the benefits created by the merger. Just last week, our technology team did a tremendous job of completing the Globex integration for all CBOT agricultural, equity index and interest rate products, and we are fully prepared to complete the combination of our trading floors by mid-May. As promised, we are on track to deliver at least $150 million of run rate synergies by the end of the year. Second, we continue to broaden the distribution of our highly relevant product set around the world. Recent partnerships in Brazil and Korea highlight our global mindset and we intend to continue to expand our reach. Third, we made a recent announcement regarding upcoming significant technology speed improvements. We are focused both on the speed within the walls of our data centers, and the speed of orders and market data between us and our customers.

- Finally, here at CME Group, we help our customers manage risk through the use of our products. Since we became a public company in 2002, there has been no greater need for risk management than right now. Fortunately, we provide the broadest set of products and the most robust and reliable technology platform, coupled with the safety and soundness of our clearing house. Most importantly, we have significant pools of liquidity which our users greatly benefit from, whether they are hedging a risk or attempting to speculate on short term movements of these instruments.

- Before I turn the call over to Jamie, I will provide a few additional details on some of our recent announcements.

- First, following unanimous approval by the Brazilian Mercantile & Futures Exchange Board of Directors, we executed our definitive agreement with BM&F, which we discussed in detail during the last conference call. We expect this deal to close in Q1, following a vote of the BM&F shareholders on February 26th. Our technology and clearing groups will be working closely with our partners. We currently expect to provide order routing in the second half of 2008, when we also bring our telecommunications hub in San Paolo online. We will work closely in conjunction with BM&F's own technology development plan. We look forward to providing our customers more direct access to the BM&F products, and to more effectively distribute CME Group's product suite to traders located in Brazil. Furthermore, we continue to forge ahead with plans to increase volume growth in Asia, and in addition to our proposed agreement with the Korea Exchange, we are also working to accelerate the distribution of our products into China, through our strategy with CFETS and the People's Bank of China.

- Second, we announced that we will significantly improve the processing speed for all of our electronically traded products. Testing, under a replay of peak market conditions, indicated that the upgraded CME Globex platform may reduce response time by up to 50 percent. Our time table is to deploy the speed enhancement first to all currency products next week, and to bring on additional products each week until we are finished with all CME Group and NYMEX products by the end of March. If history is any guide, we expect the improved speed for orders and market data to increase our volumes and deepen our liquidity. In addition to speed, reliability is also critically important, especially during peak times like right after an FOMC or non-farm payroll announcement. Scale is also very important. In January, we handled more than 3.5 billion orders on our Globex platform, and we have the scalability to handle significant growth from here. As a comparison, in January 2007, we processed about 1.2 billion orders.

- Third, following the close of our merger, we reached out to our treasury product customers for their input around potential enhancements that we could make to the treasury products when they transitioned to Globex.   In listening to our customers, and in conjunction with our analysis of the treasury futures and cash treasuries markets, we announced several important changes to our treasury products. We plan to reduce the tick sizes beginning on March 3rd for the 30-Year U.S. Treasury Bond futures contract and both the 5-Year U.S. Treasury Note futures and options on futures. When customers consider the all-in-cost of trading, these tick size changes make the products even more competitive with their cash treasury counterparts. We have heard very positive feedback from our customer base, as these changes bring the prices for the futures into parity with the cash treasury products. We are confident that these adjustments will make our treasury products increasingly attractive alternatives to the cash treasury products.

- ♦ And finally, we recently began to offer block trades for the first time ever for certain CBOT interest rate products to better facilitate the execution of large transactions by futures and cash market participants and harmonize the trading rules between CME and CBOT interest rate products. Historically, these types of trades were done entirely in the cash treasury market. And again, customer feedback has indicated that there are several users interested in the ability to execute block trades in these products.

- Turning to our OTC initiative in interest rates - yesterday, we announced that 33 buy-side participants have committed to an Early Adopter Program for CME Swaps on Swapstream, the first centrally-cleared interest rate swaps available to all over-the-counter (OTC) market participants. These new products will be centrally cleared through CME. The firms, representing a wide spectrum of US and European financial institutions, will lead the effort to bring this new and innovative product to the $272 trillion interest rate swap market. They will be the first financial institutions to benefit from the balance sheet and operational efficiencies through central counterparty clearing and straight through processing.

- In conclusion, we had a busy and prosperous year in 2007, and 2008 is off to an even better start from a growth perspective. We remain very confident about our future success, driven by our diverse product set, leading technology and clearing capabilities, and finally, the considerable talent of our entire employee base.

- ♦ Lastly, I am sure you have questions about the release that came out last week about our negotiations with NYMEX. We will not have any further comments about these negotiations beyond the information in the release until we either reach a definitive agreement or the discussions are terminated.

- ♦ Now, I would like to turn the call over to Jamie to discuss our fourth quarter financial results.

Jamie

- Thank you Craig.

- The GAAP results for the fourth quarter were outlined in detail in the press release. In summary, we delivered net income of $201 million or $3.75 per share. Included within these results were $12.5 million of merger-related operating expenses and an $11.3 million reduction of non-operating expense related to the CBOE Exercise Rights Privilege guarantee. The merger-related costs included $4.4 million of restructuring expenses, driven primarily by headcount reductions, $3.7 million for the accelerated depreciation of data centers, and $4.4 million for integration and legal expenses. We provided a reconciliation between GAAP and pro forma results in the back of the press release, and we have also posted both GAAP and pro forma historical quarterly income statements on our Web site, starting with Q1 of 2006.

- As I move on to the details of the income statement, please note that the comparisons I reference are based on the pro forma results.

- Our **total pro forma revenue** rose 23 percent to $530 million in the fourth quarter, driven primarily by strong CME Group volumes. Average daily volume was up 23 percent while the average rate per contract was down about 1 percent.

- Our **average rate per contract** was 64.8 cents in Q4, down from 65.4 cents in Q4 last year, but up from 62.2 cents in the third quarter of 2007. The primary driver of the sequential increase in the RPC was product mix as interest rate products accounted for 60 percent of total volume in the quarter compared to 64 percent in Q3. In addition, we had a positive change in the member/non-member mix in the fourth quarter. Lastly, we had a favorable venue mix with 81 percent of the volume in Q4 traded electronically, up from 77 percent in Q3.

- **Quotation data fees** were $50 million for the quarter, up 11 percent from $45 million in Q4 of 2006. At the end of the quarter, we had approximately 293,000 users who subscribed for the base devices, up more than 5,000 compared to the third quarter. In January of 2008, we increased our fee per market data screen from $50 to $55. This increase may be offset somewhat by decreased demand due to the price sensitivity of some customers and the potential impact of staffing reductions on Wall Street.

- Our fourth-quarter processing services revenue was $16.1 million. In Q407, we handled more than 850,000 NYMEX contracts per day, up from 800,000 contracts in Q3, and 371,000 contracts per day in the fourth quarter of last year. During this quarter, revenue from NYMEX totaled $15.6 million, which averaged 29 cents per contract.

- I'll now take a few minutes to review expenses.

- **Total pro forma operating expenses** for Q4 were $204 million, up 1 percent versus $203 million for Q4 last year. Comparing to the third quarter of this year on a combined basis, expenses were down $6 million or 3 percent. This sequential reduction was driven primarily by lower compensation expense.

- **Total compensation-related expense** decreased from $81 million to $72 million. There are three components of this expense: salaries and benefits, bonus and stock-based compensation. Salaries and benefits totaled $54 million, down $2 million sequentially. As of December 31st, the CME Group headcount stood at 1,970, down 20 since the end of the third quarter and down about 180 since the merger. Next, our employee bonus accrual totaled $11 million, down $7 million versus Q3 as we reached the maximum bonus payout for the year. And finally, the stock-based portion of compensation was $7 million, which was flat relative to the prior quarter.

- All other expenses totaled $133 million in the fourth quarter, up $3 million sequentially. Approximately $2 million of the increase was related to our BM&F transaction, which primarily impacted professional fees.

- Operating margin was 61 percent on a pro forma basis, our second highest quarter ever.

- Investment income for the quarter totaled $15.3 million, down from prior quarters as we saw the full quarterly impact of lower cash balances following our share and ERP buy backs. We also had interest expense of $2 million in the fourth quarter, related to commercial paper outstanding.

- Our **pre-tax income** was $338 million in Q4, up 37 percent from the fourth quarter last year. Net income for the quarter was $202 million and diluted pro forma EPS was $3.77.

- Moving on to the **balance sheet**:

  - As of December 31st, we have $1.05 billion of cash and marketable securities, and short-term debt of $164 million resulting in a net cash position of $884 million. That is an increase of $151 million in net cash for Q4.

  - **Capital expenditures**, net of leasehold improvement allowances, totaled $74 million in the fourth quarter, driven by continued investment in our technology infrastructure, including the purchase of land and a building for a new data center for $14 million. For the full year, pro forma capital expenditures totaled $159 million.

  - I will now turn to **guidance for 2008 for CME Group.** We expect expenses for the year to range from $835 to $850 million. That would represent a 0 to 2 percent increase versus 2007 pro forma expense levels driven by normal expense growth rates less merger-related expense synergies. Historically, CME expenses have grown between 11 and 13 percent annually, and in 2008, we expect to benefit from approximately $80 million of incremental expense synergies compared to 2007. By the end of 2008, we expect to achieve run-rate expense synergies of $150 million.

- We anticipate between $225 and $235 million of capital expenditures in 2008 driven by continued technology and real estate related spend. Approximately 75% of our capital spend will be related to technology, and we expect the first phase of the build out of the new data center to total $55 million. This 260,000 square foot building will handle future volume growth and will be outfitted on a “build as we grow” basis.

- Looking ahead to 2008, we have raised the cash earnings target well above where it came in for 2007. At target, employee bonuses would be $36 million. If we are 20 percent above the 2008 cash earnings target, employee bonuses would be capped at a maximum of $57 million. In addition, we anticipate the average effective tax rate for 2008 to be approximately 40 percent. In terms of our share count, we will issue 1.19 million shares of CME stock at the close of the BM&F transaction.

- We also announced today that we declared a first-quarter dividend of $1.15 cents per share, payable March 25, 2008, to shareholders of record as of March 10. This dividend represents a 34 percent increase from the 2007 quarterly dividend of 86 cents per share.

- And finally, trading volume so far in 2008 has been exceptional. In January, we averaged 14.3 million contracts per day, up 65 percent compared to last year.

- With that, we would now like to open up the call for your questions.