CME Group 2Q17 Earnings Call Prepared Remarks – August 1, 2017

John Peschier

Good morning, and thank you for joining us. Terry and John will make some initial remarks and then we'll open up the call for your questions. Other members of our team will also participate during the Q&A.

Before they begin, I'll read the safe harbor language. Statements made on this call, and in the 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 statements. More detailed information about factors that may affect our performance may be found in our filings with the SEC, which are on our website.

Also, on the last page of the earnings release you will find a reconciliation between GAAP and Non GAAP measures.

With that, I would like to turn the call over to Terry.

Terry Duffy

- Thank you all for joining us this morning. I am going to make some initial comments, and then I'll turn it over to John.

- Our average daily volume during the second quarter grew by 9 percent to 16.5 million contracts per day. This is impressive growth, especially considering the tough comps we had last year. During the quarter, our total open interest hit record levels. We also experienced large open interest holders at record levels in several key products.

- We had double-digit volume growth in Q2 in our two largest segments – interest rates and energy. We believe we are well positioned long term in these products. Within rates, we delivered strength across the board in Eurodollars, Treasuries, including the Ultra 10, and Fed Fund futures. This was driven by exceptional liquidity, capital efficiencies and continued innovation. In Q2, the FED elaborated on their plans to reduce their balance sheet over time. This will create another dimension for the trading community to consider.

- Energy markets have been particularly dynamic. The U.S. has become the swing producer in the global crude oil market. It has been driven by increased domestic production and rising exports of WTI. This continued structural shift in the global crude market helped us achieve record levels of WTI trading, averaging 1.5 million contracts per day during the quarter.

- We are also pleased with the continued growth of Natural Gas options on Globex. It has been one of our major initiatives this year. Electronic Volumes grew 156 percent in June. We reached a record 52 percent electronic in June versus just one percent in June of 2015. Like WTI over the past two years, we believe our Henry Hub contracts will continue to rise in global relevance. This should be driven by increased U.S. shale gas production and increased U.S. exports of LNG, or liquefied natural gas. There is a clear trend. WTI and Henry Hub are being adopted as global benchmarks. This is reflected in the fact that 23 percent of our energy volume came from outside the U.S. – up from 18 percent in Q2 last year.

- Within FX, we are performing well. We are starting to reap the benefits of our approach to expanding our offering in one of the largest asset classes in the world. You see it in terms of recent volume growth. We have also seen expanded participation from bank clients. In Q2, we saw continued outperformance relative to the other two largest FX platforms in terms of trading activity. Large open interest holders in FX are up 11 percent year-over-year at CME Group.

- We are seeing early traction on our recently launched FX monthly futures targeted toward the $2.4 trillion per day FX swaps market, and so far, we have had 200 unique participants since launch. In addition, in late June we achieved an important step in our ability to provide clearing services for over-the-counter FX options by receiving a notice of non-objection from the CFTC for our margin model, which will enable us to supplement our Non-Deliverable Forward offering.

- Our metals volume continues to expand. We had our third consecutive record quarter overall. It was driven by precious metals average daily volume up 14 percent and Copper up 15 percent. Both products substantially outperformed volumes on our peer exchanges.

- Turning to options, we continued to gain traction with this important business. Options are particularly useful for customers in a low volatility environment. This is shown by strong growth in our Equity options, despite depressed levels of equity market volatility. Total options grew 21 percent compared to the same quarter last year. We saw a surge in electronic options – up 30 percent to 2.2 million contracts per day.

- From a global perspective, we continue to see strong growth. We had a record quarter in terms of ADV from both Europe and Asia. This led to a sizable jump in the percentage of total volume from outside the U.S. It also showed increased participation during non-U.S. trading hours. If you look across the 24-hour day, we saw 33 percent growth during European hours to 1.4 million contracts per day and during Asian hours, we saw 22 percent growth to 430 thousand contracts per day.

- Our focus continues to be on maximizing our results. There are certain parts of our business we feel confident that we can control to accelerate growth, such as:
  - continuing to provide superior customer service and outreach,

- providing a robust reliable technology platform, and
- consistently adding relevant new products.

- In closing, earlier last month we launched the Russell 2000 futures. We are pleased with the participation so far and are well positioned to expand that market. The Russell benefits our clients who want to manage risk in the important small-cap segment. Combined with our other equity products, it gives our customers access to all the major equity indexes on a single platform.

- I want to thank you all for your interest in CME Group, and I look forward to your questions. With that, I will now turn the call over to John for the financial results.

John Pietrowicz

- Thank you, Terry, and good morning everyone. We are very pleased to report another strong quarter. Our consistent, steady results reflect the benefits of our balanced portfolio of diverse products and our continued efforts to operate our business as efficiently as possible.

- ♦ Our solid clearing and transaction fee revenue was driven by record activity in Energy and Metals, and more than 20 percent volume growth in Interest Rates. That coupled with strong expense discipline resulted in another quarter of record adjusted net income and earnings per share.

- ♦ Overall our rate per contract for the second quarter was 74.9 cents, up 2 percent from the prior quarter. This was primarily due to a product mix shift towards our higher priced commodity products.

- ♦ Market Data came in at $96 million, relatively in line with Q1. As indicated on the last call, this will be the general range for 2017. Our additional data products and services beyond real time sales are more of a 2018 driver.

- ♦ Other revenue was down $4.6 million sequentially, the result of a few non-recurring one-time items in recent quarters. Also, our interest earnings facility investment income, which had previously run between $2.5 and $3 million per quarter and is included in the Other Revenue section, dropped to almost zero in Q2, as the vast majority of cash margin deposits have been migrated into the Fed facility, which has a higher rate of return. That revenue and expense is reflected in non-operating results.

- Moving to expenses, our second-quarter expense was $261 million, down 3 percent compared to the prior year, excluding license fees and adjustments. We are maintaining our 1 percent full-year expense growth guidance, which excludes license fees, based on expected back half spending.

- Our adjusted compensation expense was up 3 percent compared to the same quarter a year ago, but down about $2 million sequentially. Our compensation ratio in Q2 was 14.5 percent, relatively in line with Q1 and the full year of 2016.

- Looking at the non-operating income and expense line for the second quarter, our ownership in the S&P Dow Jones Indices joint venture is what drove the $32 million in net earnings from unconsolidated subsidiaries. This was the highest quarter we have seen, and up 18 percent from Q2 last year. The compound annual growth rate on this contribution has been 13 percent since 2013.

- Our returns from investing cash on behalf of our customers, increased sequentially to $21.2 million from $12.2 million in Q1.

- The tax rate in the second quarter was an adjusted 36.5 percent, up sequentially as we had guided to last quarter. Given the recent announcement of an increase in the Illinois State Income Tax starting in July, we expect our tax rate to increase by .4 percent annually, and .2 percent for the current year. For modeling purposes, I would suggest you use 36.8 percent in the second half or 36.5 percent for 2017.

- And now to the balance sheet – At the end of the second quarter, we had approximately $1.45 billion in cash and marketable securities. We paid out $223 million in June through our regular quarterly dividend. It is worth noting we have returned approximately $8 billion to shareholders in the form of dividends since the implementation of the variable dividend policy in early 2012.

- Finally, during the second quarter, capital expenditures, net of leasehold improvement allowances, totaled $16.5 million. For the year, we now expect $90 to $95 million of CAPEX.

- In summary, we continue to execute well on our plans in an efficient and effective manner - no matter the underlying environment. We continue to work closely with our customers. We aim to improve their experience and provide them with solutions to their challenges. We also are positioning ourselves to attract more new users from around the world to our deep, liquid, capital-efficient markets. For the quarter, our efforts resulted in record adjusted net income and earnings per share. We intend to continue moving forward along this proven path to drive long-term value creation for both customers and shareholders.

- With that, we'd like to open up the call for your questions. Given the number of analysts who cover us, we ask that you limit yourself to one question so we can get to everyone. Thank you.

Statements in this document 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, develop strategic relationships and attract new customers; our ability to expand and offer our products outside the United States; changes in regulations, including the impact of any changes in laws or government policy with respect to 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; 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 financial safeguards package to adequately protect us from the credit risks of clearing members; 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; changes in price *levels and volatility in the derivatives markets and in underlying equity, foreign exchange, interest rate and commodities markets; economic, 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; 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 and control the costs associated with our strategy for acquisitions, investments and alliances; 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 on futures transactions and/or repeal of the 60/40 tax treatment of such transactions; and the unfavorable resolution of material legal proceedings. For a detailed discussion of these and other factors that might affect our performance, see our filings with the Securities and Exchange Commission, including our most recent periodic reports filed on Form 10-K and Form 10-Q.*