Q310 Earnings Call Prepared Remarks
October 28, 2010

John

Thank you for joining us. Craig Donohue, our CEO, and Jamie Parisi, our CFO, will spend a few minutes outlining the highlights of the third quarter and then we will open up the call for your questions.

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 Forms 10-K and 10-Q, which are available in the Investor Relations section of the CME Group Web site.

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

Craig

- Thank you for joining us this morning. I'll be discussing our performance in the third quarter and providing updates on a few of our strategic initiatives before turning things over to Jamie Parisi to review the financials.

- CME posted solid third quarter results with average daily volume up 14 percent from the same period last year, net income up 21 percent to $244 million, and earnings per share of $3.66, up 20 percent.

- The foundation of our performance lies in our product diversity. Energy and metals contribute 32 percent of transaction fee revenues, interest rates 27 percent, equities 21 percent, and foreign exchange and commodity products contribute the remainder. The breadth and diversity of our product lines is beneficial when we face macroeconomic headwinds in particular market segments. Importantly, I'll note that though we've seen volume performance within the individual asset classes vary throughout the year, we have continued to see open interest build from quarter to quarter in every one of our product lines. Open interest currently sits at 92.4 million contracts, up 12 percent compared to the same period last year, and just below the all time record of 95 million.

- To review some of our volume statistics:

- Third quarter average daily volume was up 14 percent versus the same period last year and was down 15 percent versus the second quarter of this year, due to extraordinary performance in Q2 and the typical impacts of seasonality seen during July and August.

- Turning to Interest Rates, diminished activity in short-term rates was significantly offset by strong growth in our Treasury products as I will describe in a moment. Average daily Eurodollar volume was down 7 percent. However, longer-dated Eurodollar contracts with expirations beyond September 2012 saw record average daily volume of 320,000 contracts, up 32 percent from the prior year, as there continues to be more volatility at the long end of the curve. Eurodollar midcurve options, which are short-dated expirations on longer-dated futures contracts, have also experienced impressive volume growth this quarter, from approximately 6,000 ADV last year to 87,000 this quarter, and with open interest growing from 330,000 to 1.2 million today at quarter end.

- Importantly, Eurodollar open interest across the whole yield curve continues to grow, including in the first two years. While short-term interest rates continue to be affected by monetary policy, it is important to recognize that Eurodollar products represent only 12 percent of total transaction fees at CME Group.

- As I mentioned, Treasury products had a very strong third quarter with average daily futures volumes up 38 percent and with options volumes up 62 percent. As we've seen expectations for interest rate increases move out on the curve, products at the longer end of the curve are seeing greater activity. An additional positive to this strong Treasury volume is that the Treasuries rate per contract is generally higher than the Eurodollar RPC.

- We also continue to successfully innovate new products and product extensions that meet customer needs and enhance our performance in this segment of our business. We've had tremendous success with our Ultra-long Bond Treasury futures, which posted average daily volumes of 33,000 in Q3 and open interest of 222,000, and we just this week launched On-the-Run Treasury futures contracts, which our customers are very excited about. The robust liquidity and diverse customer base in our core Treasury products enables us to effectively develop these product extensions, which in turn allows us to provide our customers with more trading opportunities at CME Group.

- In other product areas, average daily volume in our Equity Products was up 6 percent for the quarter, outperforming cash equity market volumes and reflecting asset allocation preferences and the outflow of funds from equities to fixed income markets throughout 2010.

- Average daily volume in our FX Products was up 31 percent over third quarter last year, and open interest trends remain positive, with current levels at a near record of 1.6 million. Growth in CME FX is coming from diverse sources. We saw 40 percent volume growth in the Australian and Canadian Dollar markets, which historically have been less actively-traded currency pairs at CME. Additionally, FX activity was up 54 percent during non-U.S. trading hours and this asset class continues to be our fastest growing segment during non-U.S. hours.

- FX options also continue to perform extremely well, with average daily volume up 182 percent over third quarter of 2009, and open interest growth of 101 percent versus the same time period.

- Finally, another positive indicator for our FX business came out of the recently released BIS Triennial survey, which showed that the global FX market grew 20 percent from April 2007 to April 2010, while CME's FX volume grew 94 percent in that same period, clearly demonstrating the increasing importance of our products to the global FX marketplace. The BIS survey also indicated that global FX options declined 2 percent while CME FX option volumes grew 250 percent. We believe there are three factors driving this outperformance: 1) CME's central counterparty clearing which enables wider participation by a diverse set of buy side customers, 2) significantly expanding liquidity across a broad range of CME currency pairs as our FX markets have become a major source of liquidity in global FX markets, and 3) electronic access to both futures and options on our CME Globex electronic trading platform. Together, these factors should continue to drive growth in our FX business.

- To round out our other asset classes, our agricultural commodity, energy and metals products have all shown outstanding growth year-to-date and also are on track for a strong fourth quarter. These products tend to earn our highest rates per contract, so growth here is very accretive. Agricultural commodities had a strong quarter, with volumes up 33 percent versus last year, led by outstanding growth in corn and wheat volumes of 56 percent and 72 percent, respectively. Energy was up 12 percent, to 1.7 million contracts per day, our second highest quarterly volume, and energy open interest remains at near record levels. Finally, metals average daily volume was up 28 percent.

- I would also like to touch on continued growth in international volumes in our core product lines: During the third quarter, we saw strong growth of

37% in Globex volumes during non-U.S. hours. Volume from our various international hubs also grew 15 percent compared to the same quarter a year ago, and now represents 15 percent of overall Globex volumes. We continue to focus on globalization of our core businesses as we expect growth in emerging markets to outpace growth in more developed markets.

- One example of our commitment to achieving growth from globalization is our recently announced enhancements to our global client development and sales organization,. Our new structure will better enable us to cross-sell all CME Group products and services to our global customers while also allowing us to better understand and meet the needs of our largest customer segments, including banks, intermediaries, asset managers, hedge funds, proprietary trading firms, and commercial participants. The new structure has been designed to better target cross asset sales across client segments, to drive international sales, specifically in Asia and Europe, and to generate new client participation across all regions. The ultimate goal is to more effectively serve our clients and enhance our global sales and marketing efforts for the entire suite of CME Group products. During the quarter, we hired a new head of Global Client Development & Sales, Ali Hackett, formerly Managing Director, Co-Head of Global Prime Finance at Citigroup, who will oversee our worldwide client development and sales efforts.

- Moving on to our strategic initiatives, we were very pleased to extend our over-the-counter clearing services into interest rates with the launch of Cleared OTC Interest Rate Swaps on October 18th. This offering provides the extensive counterparty risk reduction and transparency of CME Clearing while preserving the prevailing execution processes, technology platforms, and economic structures used in the bilateral IRS market today. As a clearing-only provider in this space, we are execution-agnostic and offer operational flexibility to our customers by accepting trades from a variety of venues. Finally, as we continue to build our OTC offerings in other asset classes, CME Group has a significant lead in providing a comprehensive multi-asset class clearing solution to the market for the maximum operational ease and capital efficiency that comes with connecting to a single clearing house.

- To date, we've cleared $660 million in interest rate swaps and have $648 million in open interest, with participation across a wide variety of firms. We see this effort as being in the very early stages, and recognize that many clients are waiting for greater clarity on final rules before moving forward with cleared interest rate swaps. Currently, we are focused on delivering key additions to the offering in order to make it possible for more users to access the services. Some of the details we are working towards include receiving approval for a structure to allow cross margining with exchange-traded futures and finalizing regulatory approvals allowing certain types of mutual funds to post collateral. We are also working on expanding the product scope to offer more product flexibility and swaps denominated in additional currencies.

- I'd also like to share an update on the development of our co-location services offering for all CME Group customers. Our offering will allow customers to co-locate their servers in CME Group's new, state-of-the-art data center.

- Co-location will create the lowest possible latency hosting environment for customers. The offering is available to all customers, and all customers will be treated equally, with transparent and market-based pricing. Equidistant access points will ensure fair and equal access.

- The uptake during our initial application period has been positive and we are in the process of allocating space to our customers. Once customer space for this phase is allocated, we will begin the build out process, and are planning an early 2012 go live date. Based on current indications of interest from our customers, we expect this service to add approximately $30 to $40 million in revenue in 2012 and to further scale from there.

- Finally, I'd like to offer a brief regulatory update. We are participating actively in the Dodd-Frank rulemaking processes being undertaken by the CFTC and other financial and markets regulators to implement the new Act. Our team is working with regulators and customers to ensure that new regulations create a fair and level playing field for all market participants and that US markets are not disadvantaged compared to other global market centers.

- The CFTC and other regulators will be issuing rule proposals in many areas over the next few months. Like many of you, we are already engaging in the public comment process and anticipate a robust and healthy dialogue about the many issues the regulators are addressing. We will continue to keep you posted on these critical topics as they develop.

- In conclusion, CME Group continues to be successful in managing our core business and executing on our strategy to further globalize our business and to expand our capabilities into the OTC markets. While the macroeconomic climate has been challenging for everyone, our performance over the past two years has proven that we can leverage our diverse product set to deliver results in a variety of cyclical and economic environments.

- With that, I'll turn the call over to Jamie.

Jamie

- Thank you Craig.

- CME Group posted solid third quarter financial results, with average daily volume of 11.6 million contracts per day, up 14 percent versus Q3 of last year, driving a 13 percent increase in revenue to $733 million. We delivered $443 million of operating income, a 60 percent operating margin and diluted earnings per share of $3.66.

- The overall rate per contract decreased 3 percent to 81.0 cents, compared with 83.4 cents in the third quarter 2009, due to higher growth from members versus non members, and higher tier discounts. So, average daily volume was up 14 percent, while the average rate was down 3 percent. Sequentially, the rate per contract increased 3 percent, due to favorable mix factors, including a stronger participation from our highest paying non members.

- Market data revenue of $101 million for the quarter was down less than 1 percent compared to Q2, primarily due to a decrease in the Dow Jones Indexes revenue attributable primarily to lower equity assets under management. Subscribers to CME, CBOT and NYMEX data increased their activity somewhat in Q3, with the total terminal count up slightly to 385,000. This was the first increase in sequential screen counts since Q2 of 2008, signaling some stabilization relative to the trend we have seen since the credit crisis began.

- Lastly, with respect to the Other Revenue line in Q3, we recognized $5.1 from BM&FBOVESPA related to the build out of our multi asset class trading platform.

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

- Drilling into Q3 expenses, compensation and benefits was $110 million, up $7 million from the prior quarter. $5.1 million of this increase was based on a sequential change in deferred compensation expense. Remember, there is a 1 for 1 offset in the investment income line for this item, so there is no bottom line impact. In addition, our combined headcount at the end of Q3 stood at 2,520, an increase of 60 people during the third quarter, reflecting our continued investment in growth opportunities.

- Q3 Marketing and Other expense included approximately $4.7 million related to resolving customer losses associated with the CME Globex errant trade issue which occurred in September, while there was a $2.1 million tax and operating accrual adjustment, which decreased Occupancy and Building expenses for the quarter.

- We now expect our second half 2010 expenses to come in near the top end of our prior guidance range of $573 to $583 million, with the one-time cost of the errant trades and higher deferred compensation pushing us to that level.

- In the Non-Operating Income and Expense category, Investment Income was up $8 million sequentially, due to a $3 million increase in the BM&FBOVESPA dividend, plus the $5 million increase in deferred comp earnings mentioned earlier. Equity in Losses of Unconsolidated Subsidiaries reflects a $2 million increase, due to writing down to zero our investment in OneChicago, our single stock futures JV.

- In the third quarter, we paid down $300 million of debt, bringing our total debt to $2.5 billion, which reduced interest expense by $2 million. Our debt to EBITDA ratio is now under 1.3X. A detailed illustration of our debt structure is included in our earnings slides. At the end of the third quarter, we had approximately $613 million of cash and marketable securities on our balance sheet.

- For the quarter, our effective tax rate was 41.2 percent. We expect our tax rate to fall between 41 and 42 percent in total for the year.

- Capital expenditures, net of leasehold improvement allowances, totaled $44 million in the third quarter, driven primarily by hardware and software purchases tied to the migration of our Globex trading system to our new data center, additional investment in the datacenter related to our co-location offering, as well as continued build out of our office facilities. We expect our capital expenditures to come in near the low end of our full year guidance of $180 to $200 million.

- Turning to recent volumes, so far in October, ADV is tracking at similar levels to Q3 at 11.4 million, up 9 percent compared with the same timeframe last year.

- In summary, we added to our solid 2010 financial performance in the third quarter. So far this year, we have generated over $800 million of cash earnings while investing significantly in growth initiatives, and paying down $400 million of debt. We are well on our way to returning excess capital to shareholders as early as next year.

- We will now open up the call for your questions. In order to get to everyone, we are limiting all of you to one question and one follow up, and then please feel free to get back in the queue if time permits.

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. 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 and implementation of the enhanced functionality required by our customers; 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 generate revenues from our processing services; our ability to maintain existing customers, develop strategic relationships and attract new customers; our ability to expand and offer our products in foreign jurisdictions; changes in government policy, including policies relating to common or directed clearing and changes resulting from the adoption and implementation of the Dodd-Frank Act and any changes in the regulation of our industry with respect to speculative trading in commodity interests and derivative contracts; the costs associated with protecting our intellectual property rights and our ability to operate our business without violating the intellectual property rights of others; our ability to generate revenue from our market data that may be reduced or eliminated by the growth of electronic trading, the state of the overall economy or declines in subscriptions; 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; changes in price levels and volatility in the derivatives markets and in underlying fixed income, equity, foreign exchange and commodities markets; economic, political and market conditions, including the recent volatility of the capital and credit markets and the impact of current economic conditions on the trading activity of our current and potential customers; our ability to accommodate increases in trading volume and order transaction traffic without failure or degradation of performance of our 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 acquisition, investment and alliance strategy; 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 on futures and options on futures transactions and/or the repeal of the 60/40 tax treatment of such transactions; the unfavorable resolution of material legal proceedings and the seasonality of the futures business. More detailed information about factors that may affect our performance may be found in our filings with the Securities and Exchange Commission, including our most recent periodic reports filed on Form 10-K and Form 10-Q, which are available in the Investor Relations section of the CME Group Web site. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.