

CME Group – Q315 Prepared Remarks – OCT 29, 2015

Phupinder Gill

- ◆ Thank you Mr. Peschier, and thank you all for joining us today. We had an outstanding third-quarter across the board. We delivered significant top line growth in transaction fees and market data revenue, which coupled with solid expense control, resulted in a 21 percent increase in adjusted earnings per share.
- ◆ We continue to benefit from revenue strength that is fairly balanced – total transaction fee revenue growth for the third quarter was 12 percent. Commodity products were 14 percent higher and financial products were up 10 percent. I will go through the highlights of these two segments for the quarter, and then I'll touch on our growth initiatives.
- ◆ Starting with commodities, all three product areas were up double digits in terms of volume. Within energy, average daily volume was up 26 percent, driven by more than 30 percent growth in our crude business, while natural gas and refined products have done well, up 9 percent in total. Our WTI futures and options volume was up 39 percent in Q3 while the other major crude offering traded at a competitor was up 7 percent. Recently, the Goldman Sachs Commodity Index preliminary reweightings were released. The WTI futures are now the largest component, and represent 23 percent of the total index which clearly reflects our clients' choice in risk management tools among our crude oil liquidity pools. Additionally, our WTI Options increased by 50 percent for the quarter.
- ◆ Turning to Ags, we are tracking for a record volume year. During the third quarter, our Ag volume was up 20 percent, with continued strength after a record quarter in Q2. Some highlights include Corn which was up 40 percent year over year, and wheat which is up 29 percent. Within metals, precious metals rose 12 percent, while the smaller base metals grew by 26 percent.

- During the quarter, we continued to rollout innovative new commodities products. We announced a South American Short Dated Soybean option contract offering South American producers a flexible and cost-effective tool to manage new crop price risk. And on the back of our success in the Copper business, which is up 26 percent in Q3, we continue to expand our base metals product suite. In addition to launching Zinc futures, we are also launching a global physically delivered lead contract with U.S. and European delivery points, as well as new Aluminum European Premium futures, following success with our U.S. Midwest premium futures. On the European Energy side, we launched a suite of European Power contracts to compliment the European Gas futures that we launched in January, which will be further enhanced by European Emissions futures that we plan to launch in the next month. I will touch on some interesting new partnerships in a few minutes.
- Moving on to our financial products – we had an impressive quarter in our equity business, with volume up 27 percent driven by increased volatility. Equity options growth during the quarter was 32 percent. During the month of August, we had the two highest days ever in our equity options products, with both days above 1.9 million contracts.
- ♦ Within interest rates and FX, we have seen some slowdown in activity as a result of the expectations of a FED move being pushed out several months. We have seen that before and the opportunity remains in front of us. We continue to innovate and believe we are well positioned in those products. CME Fed Fund futures volumes have tripled and open interest has doubled this year as the market has used the Fed Fund futures contracts to manage risk in relation to uncertainty of Fed rate hikes. The CME Fedwatch tool that translate Fed Fund future prices into probability of rate moves by the FOMC gives a more than 30 percent chance of a rate move in December and over 50 percent chance of a rate move by March of 2016.

- ◆ From a growth perspective – a couple of important points. In early August, we were pleased to announce the licensing deal with FTSE Russell Indexes, and we look forward to driving growth in these products. We have already launched futures on the Russell 1000, Russell 1000 Growth and Value, FTSE 100, Emerging Markets, and FTSE China 50 indexes and other products. We will be rolling out the FTSE Emerging Markets and the FTSE Developed Europe in 2016, and most importantly, the Russell 2000 in 2017. In addition, on November 16 we plan to launch S&P Dividend Index Futures as well as introducing the so called Basis Trade Index at Close or BTIC functionality to the S&P 500, NASDAQ, and Dow Jones index futures.
- ◆ Within interest rates, last week we announced plans to launch the Ultra 10-Year Treasury note futures and options contract which I eluded to last quarter. This contract provides hedging and spreading opportunities at the “true” 10-year point of the Treasury yield curve. Market participants approached us in the first half of this year and suggested that we look at a futures contract that can provide deep liquidity and capital and margin efficiencies of the Treasury futures complex to the highly traded ten year point on the treasury yield curve. CME conducted an extensive market validation process of three potential contract designs. We found great enthusiasm, interest, and deeply held views on the design and usefulness from market participants. The design announcement for the new Ultra 10Y futures has elicited significant positive feedback from our customers.
- ◆ Looking at our global business, we had the best quarter ever in terms of volume and percentage of total volume from outside the US. The total electronic average daily volume for the quarter of 3.2 million contracts was up 15 percent from the prior year. In addition, the total electronic volume traded from outside of the US exceeded 25 percent for the first time, and revenue from outside of the US represented 32 percent of the total. Our interest rate business has been particularly strong outside the US, as electronic revenue has grown from 31

percent in Q3 last year, to 37 percent this quarter.

- ◆ We continue to establish global partnerships, particularly in Asia over the last few months. We announced an exclusive license arrangement with Rim Intelligence, a leading provider of pricing data in Japan, to develop and clear energy derivatives based on their LNG data. Secondly, we signed an MOU with MCX, India's leading commodity exchange, related to product development, market education and a licensing agreement for Rupee-denominated oil and gas contracts based on NYMEX prices.
- ◆ We have made three noteworthy announcements with Chinese entities. We announced an index development and product licensing agreement with China Securities Index Co for commodity index development. We signed an agreement with CFETS, China's largest marketplace for interest rate and foreign exchange products, related to joint development and innovation of offshore Renminbi and related products. As part of the agreement, CFETS will help facilitate China interbank market participants to trade CME Group's products. And finally, last week, we signed an MOU with China Construction Bank, to offer Offshore Chinese RMB futures contracts with physical delivery in London for the first time, which will be offered via CME Europe. We believe our cooperative efforts will continue to unlock opportunities for our shareholders, as we continue to grow our customer base and volume around the world.
- ◆ Turning to our options business - As you know we have invested in system enhancements, new products and investor education, which are driving significant usage of our diverse suite of Option products. Q3 options volume reached a record level of 2.9 million contracts per day. We also saw the highest percentage of this business trading electronically, which reached 55 percent electronic during the quarter. One of the key drivers of our continued electronic options success is our investment in enabling more complex Options spreads to trade on Globex. In

Q3, we saw a record 45 percent of all Options spreads trade electronically, versus just 10 percent in 2010. And volume in the world's largest major options contracts, our Eurodollar options traded on Globex, jumped by more than 60 percent to a record 200,000 contracts per day in Q3, and reached 21 percent electronic versus 14 percent a year ago.

- ◆ In summary, we continue to deliver strong results, but more importantly, we are intensely focused on running the business as efficiently as we can, while laying the foundation for future growth in the years to come. I am going to turn the call over to John to discuss the financials. Thank you

John Pietrowicz

- Thank you Gill, and good morning everyone.
- ♦ CME had a strong quarter. Another great job by the team on both the revenue and expense side with revenue up 12 percent and expenses basically flat. Our adjusted operating margin of 62.7 percent was the highest level we've seen since 2011. Finally, our adjusted EPS grew 21 percent during the quarter, compared to the prior year driven by organic growth.
- ♦ I'll start with some revenue details:
- ♦ The rate per contract for the third quarter was 75.9 cents, down from 77.7 cents last quarter driven primarily by a product shift from ags to equities, volume discounts and a drop in the Energy RPC as a result of the contract mix. In September, within energy, we saw a significant increase in our small-sized power contracts, which accounted for 8 percent of the energy volume per that month, or 161 thousand contracts per day. During the second quarter, the power contracts accounted for less than one half of 1 percent of the volume, and for Q3 that jumped up to 5 percent at an average of 6 cents per contract.
- ♦ Cleared swaps revenue totaled \$16.3 million for the quarter. We captured \$166 per IRS cleared trade, higher than we've seen in prior quarters due to our customer mix. We cleared approximately 1,370 trades per day in Q3.
- ♦ Market data revenue of \$99.5 million was up 13 percent versus Q3 last year, driven primarily by the elimination of our fee waiver program, which we have discussed the last few quarters. This came in slightly below our guidance, and we would expect it to dip slightly in Q4.

- ◆ Adjusted operating expenses for the third quarter were \$317 million, down from last year. We remain extremely focused on driving efficiency throughout the organization, and eliminating redundancy to continue to improve agility, and customer and market responsiveness.
- ◆ At the end of the quarter, we had 2,525 employees, down 5 percent from 3 months ago driven by our futures pit closures in July and staff reductions in August. Our headcount is down 11 percent from the same quarter last year. Stock based compensation costs came in below our normal run rate primarily due to higher forfeitures on expenses we had previously recognized. After some variability in our stock based compensation the last 2 quarters, we expect to revert to a run-rate of approximately \$15 million per quarter. Modest fluctuations may result in future periods due to the changes in expectations regarding achievement of performance share targets.
- ◆ Our compensation ratio year to date is running at an industry leading 16.1 percent, down from 17.1 percent in 2014 and 17.4 percent in 2013. During the quarter it came in at 15.4 percent.
- ◆ Looking at the non-operating income and expense line, our ownership in the S&P Dow Jones joint venture drove the \$26.6 million in net earnings from unconsolidated subsidiaries, which was up 33 percent from the prior year. We remain pleased with the investment we made in the index business, while also assuring we continue to offer the world's leading index futures products on CME.
- ◆ Turning to taxes, the effective rate for the quarter was 36.3 percent. I expect the fourth quarter to be approximately 37 percent, for a full year tax rate of 36.6 percent.

- ◆ And now to the balance sheet – at the end of the third quarter, we had \$1.61 billion in cash, restricted cash and marketable securities. That is approximately \$910 million above our \$700 million minimum cash target.
- ◆ During the third quarter, capital expenditures, net of leasehold improvement allowances was \$30 million, and year to date CAPEX has totaled \$85 million. We expect full-year 2015 CAPEX to be back end loaded in Q4, and should come in lower than we expected at approximately \$125 million.
- ◆ For the full year expenses – we initially guided to \$1.31 billion, which we reduced by \$10 million last quarter, and I am going to reduce that by another \$5 million to \$1.295 billion. This includes absorbing a \$12 million increase in license fees so far this year based on volume growth. The guidance would result in a 2 percent expense reduction in Q4 compared to the prior year on an adjusted basis. As we mention at this time every year, we have a large amount of marketing and customer related spend in the fourth quarter that will drive the sequential increase from Q3.
- ◆ Finally, we communicated an adjusted 2016 transaction fee schedule across all 6 product areas to our customers last week. We expect the transaction fee revenue to increase approximately 2 percent assuming the same volume levels and product mix next year.
- ◆ In summary, the third quarter of 2015 once again demonstrated the power of CME Group's business model. Broad based volume growth from our diverse product set and our disciplined expense management drove adjusted EPS up more than 20 percent, continuing our growth in the first half of the year. We also continued to generate a significant amount of excess cash, which we plan to return to our 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. Please feel free to get back into the queue, if you have any further questions. 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 domestic and non-U.S. regulations, including the impact of any changes in domestic and foreign 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; the unfavorable resolution of material legal proceedings; and the seasonality of the futures business. 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.