

CME Group Q117 Earnings Call Prepared Remarks – April 27, 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

- ◆ Thanks, John, and 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, who will share the financial highlights.
- ◆ Our overall volumes remained high during the first quarter, even though there were pockets of low volatility in equity and energy markets. We delivered record average daily volume of more than 17 million contracts. This includes all-time highs in Interest Rates and Metals average daily volume. Activity from outside the United States remained strong, the volume averaged more than 3.5 million contracts per day.
- ◆ Within fixed income, we had broad-based strength across Eurodollars, Treasuries, and Fed Fund Futures during Q1. This has been driven by recent outsized growth from our buy-side customers. We continue to see strong performance in our Treasury futures relative to the cash Treasuries market.
- ◆ Our Metals portfolio, which was our fastest-growing asset class in the first quarter, delivered outstanding activity with more than 510,000 contracts traded per day, driven by growth in both precious and base metals. Our performance in Copper was particularly impressive, with 23 percent growth to almost 95,000 contracts per day during the quarter, even more impressive considering that our primary competitor in Copper saw their business decline 8 percent in that same timeframe.
- ◆ We continued to gain traction with our Options business. Here, we have taken an enterprise-wide approach by enhancing our technology, better equipping our sales force to engage with clients, and launching some innovative new products.

Last year, we generated a combined \$552 million of transaction revenue in options. This makes us the world's largest options exchange by that measure. During Q1, we reached record average daily volume in both Interest Rate and Equity options. In March, our Eurodollar options average daily volume grew 73 percent to 1.7 million contracts per day. Of that, 29 percent was electronic – the highest monthly percentage yet and the April electronic percentage to date is even higher. And in Natural Gas options, we grew our daily volumes 20 percent during the quarter, 40 percent of which traded electronically, helping us to achieve a market share of 70 percent in March.

- ◆ New products and product extensions continue to perform well. Our Ultra 10-Year Treasury futures and options exceeded 100,000 contracts per day in Q1. This was nearly triple the activity from a year ago. We launched monthly FX futures recently, and have had some early success there. In Metals, we saw record volumes and open interest in our suite of Aluminum Premium products which we launched last year, confirming global demand for these innovative risk management tools. In Equities, we have seen some traction in our S&P Select Sector futures. In early April, we launched weekly E-mini S&P 500 Monday options. On the first expiration, we traded over 53,000 contracts during that day alone. Additionally, the E-mini S&P Wednesday weekly options we launched in September 2016 have achieved 51,000 contracts per day in 2017 so far. Combined, the Monday and Wednesdays are recently producing more than 10 percent of our total equity options trading. We think these short-dated products are very appealing and valuable to customers – especially given the geopolitical concerns, and uncertainty around European elections.
- ◆ I mentioned last quarter that we are heavily focused on expanding our

customer base by focusing on end user customers. Our main objective is to identify potential clients that may be using less efficient products and convert them to CME Group offerings. We are making progress. For example, we have record open interest or large open interest holders in three key areas:

- ◆ One is in our Interest Rate business where we achieved an open interest record of over 74 million contracts, including records in Eurodollar futures, Treasury futures, Fed Fund futures, driven in large part by asset managers.
- ◆ The other is in our Energy futures business, where we achieved new record levels of open interest during Q1 in our WTI, Gasoline and Heating Oil futures. Additionally, we hit an approximate 4-year high in Natural Gas futures open interest and grew our ADV by 24 percent while our competition shrunk 3 percent, allowing us to increase our year-to-date market share to 78 percent versus 75 percent in March of 2016.
- ◆ While our trading in FX was down during the quarter, we significantly outperformed the two primary competitive venues and we are pleased to reach a record level of large open interest holders toward the end of February. More important, we saw banks reappear as our fastest growing segment during the quarter in FX.
- ◆ The other thing we are focused on is operational efficiency. We continue to ensure that we are allocating our time and resources in the best way possible. A few weeks ago, we announced that we will be closing our European exchange

and clearing house by year-end. Our customers have clearly shown that they prefer to use our U. S. infrastructure to access our global products, deep liquidity and capital efficiencies. We will maintain a significant operation based in London, however, it will be focused on direct sales of our core products.

- ◆ While there are several positive trends in our business, one area I wanted to briefly touch on is market data. We outlined an ambitious plan last quarter to supplement our traditional real-time data business with several new data offerings. We referenced increasing the data sales team focused on derived data, offering a new cloud based data platform, along with building out an audit function rather than outsourcing it. We are currently augmenting our organization to capture these opportunities. Frankly, we underestimated the complexity of resourcing our team, which will not allow us to achieve the guidance we previously outlined. Therefore, we do not expect these initiatives to drive any incremental data revenue for this year.
- ◆ Lastly, our April trading volume has remained strong, during what is usually a slower time of the year. Volume is averaging approximately 16 million contracts per day, and we are seeing 20 percent growth month-to-date. We intend to build on our strong momentum by providing outstanding value to our customers. In closing, I'd like to thank our employees for all of their hard work this quarter. With that, let me hand it over to John.

John Pietrowicz

- Thank you, Terry, and good morning everyone. We are very pleased to start off the year with a strong quarter. Our team continues to be intensely focused on driving global revenue growth, operating our business as efficiently as possible, and returning excess capital to our shareholders.
- ◆ We had an exceptional quarter, as we did in the first quarter of last year. As Terry, mentioned, we had the highest quarterly ADV in our history, and we also had record net income and earnings per share on an adjusted basis.
- ◆ Our overall rate per contract for the first quarter was 73.1 cents, the same level we had the prior quarter, despite an almost 3 percent product mix shift toward our lower priced interest rate products.
- ◆ Market Data came in at \$97 million, down from Q4 as several larger customers consolidated trading operations and their terminal usage.
- ◆ Moving to expenses, excluding license fees and adjustments, our first-quarter total expense was approximately \$267 million, in line with our original guidance. Earlier this month, we announced our intention to wind down a portion of our European operations by year-end. We expect the annual savings to be between \$10 and \$12 million, which will primarily impact 2018, as it will take us some time to fully complete the process. Eventually, we also expect to free up over \$150 million in capital related to these entities. Additionally, because of the transfer of the Russell products in July, as well as aggregate changes in our licenses, we would expect our license fees in the second half of this year to increase 10 to 15 percent versus the same period last year, assuming similar trading patterns.

- ◆ Our adjusted compensation expense increased by 4 percent primarily driven by normal cost of living increases, as well as hiring additional technology staff in India and Belfast, which over time we expect will reduce higher cost professional fees. Our compensation ratio in Q1 was 14.7 percent, about the same level as we had for the full year of 2016.
- ◆ Looking at the non-operating income and expense line for the first quarter, our ownership in the S&P Dow Jones Indices joint venture primarily drove the \$31 million in net earnings from unconsolidated subsidiaries. This was the highest quarter we have seen, and up 15 percent from Q1 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 \$12.2 million from \$8.4 million in Q4. Considering current cash positions, we expect the investment returns to increase again in Q2, as we will have the first full-quarter impact of CME Clearing's approval to hold customer cash performance bond deposits in a Federal Reserve Bank account.
- ◆ The tax rate in the first quarter was an adjusted 35.5 percent. We expect the rate to be higher in the second quarter, and we expect an effective rate of 36.3 percent for the full year.
- ◆ And now to the balance sheet – At the end of the first quarter, we had approximately \$1.37 billion in cash and marketable securities, which includes \$240 million of cash from our final BM&FBOVESPA stock sale in January. It is worth noting, we also returned \$1.1 billion in January through our annual variable dividend and approximately \$220 million in March through our regular quarterly dividend.

- ◆ Finally, during the first quarter, capital expenditures, net of leasehold improvement allowances, were \$15.5 million.
- ◆ In summary, it's been a great start to the year. We reached a peak level of volume, adjusted net income and adjusted earnings per share. We intend to remain very focused on efficiency coupled with enhancing the value proposition of using our markets to attract new customers.
- ◆ With that, we'd like to open the call for your questions. Thank you.

Statements in this press release 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.