CME Group Q416 Earnings Call Prepared Remarks – February 2, 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. Welcome everyone, and thank you for participating today. Before going into the details of our performance, I want to start out with a few comments. Then I look forward to spending time focused on your questions.

- As most of you know, I have been heavily involved in leading our growth strategy since we decided to go public in 2002. I had the good fortune to lead the IPO and roadshow, and have been involved ever since.

- In 2007 and 2008, I oversaw the acquisition of the Chicago Board of Trade and the New York Mercantile Exchange. These two transactions were a cornerstone of our growth strategy. They have led to the tremendous product diversity and deep liquidity that we provide our customers around the world today.

- One of the things we're always focused on is meeting our clients' ever-changing needs. This requires continued innovation and the development of new, capital-efficient solutions.

- One example of the benefits that our clients receive is having Interest Rate swaps and Interest Rate futures in a single clearing house. This has allowed for billions of dollars in margin savings for our clients.

- In addition, we are committed to reducing our day-to-day operating cost. This frees up dollars to spend on our growth initiatives.

- Bottom line, as a company, we are well positioned to help our customers navigate today's unpredictable global environment and, in turn, deliver value to you – our shareholders.

- Before I turn things over to John, I want to make a couple of comments about today's results. Fourth-quarter volume averaged more than 16 million contracts per day, up 24 percent. That included quarterly ADV records in Interest Rates, Energy Products and Metals.

- As you know, we closely track our volume globally. For example, in the fourth quarter, trading volume rose more than 50 percent during both European and Asian trading hours. At the same time, volume during U.S. trading hours jumped 23 percent.

- In terms of the full year, we reached record levels of volume, averaging 15.6 million contracts per day. This was up 12 percent compared with 2015.

- Our global growth was also impressive. Volumes from Europe and Asia were up by 16 and 15 percent, respectively.

- Also, we continue to expand our options franchise. In 2016, we had record annual average daily volume of 3.1 million contracts, or an increase of 14 percent.

- Total revenue for the year rose by $268 million. At the same time, expenses, excluding license fees, remained relatively flat. This drove double-digit earnings growth.

- Looking ahead, I'm more optimistic than ever about all the work we've done to position the company for continued success. We believe the need for risk management will remain strong – especially as unprecedented political changes continue to unfold throughout the world.

- It was very impressive to see our open interest in December exceed 122 million contracts. This reflects the continued growth of our customer base throughout the world.

- As I said earlier, we also will continue to work closely with our customers to drive valuable product innovation. Innovation is the life blood of every institution, and I see it no differently.

- I'm encouraged by the good start we have seen so far in 2017. I want to commend my team for their hard work as we continue to manage and grow our business.

- I look forward to taking your questions in just a few minutes. But, for now, I will turn it over to John to discuss 2016 and our plans for this year. Thank you.

John Pietrowicz

- Thank you Terry, and good morning everyone. We are very pleased to finish off a tremendous year with a very strong fourth 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.

- For the full year, ADV grew 12 percent from 2015, driving an 8 percent revenue increase for the year. Adjusted operating expenses, excluding license fees, grew by less than one percent, and was below my original guidance for 2016. Global revenue growth coupled with strong cost management led to excellent operating leverage with adjusted diluted EPS growing 12 percent in 2016 to $4.53 per share.

- ♦ In Q4, we were able to grow revenue 12 percent and adjusted diluted EPS 18 percent to $1.14. I will touch on the main details.

- ♦ Our rate per contract for the fourth quarter was 73.1 cents, down from the prior quarter. This was primarily due to a higher proportion of overall trading in Interest Rates, as well as an increased proportion of activity from members during the quarter.

- ♦ Market Data and Access and Communication Fees were up $1 million and $2 million versus Q4 last year, respectively. In addition, Other Revenue increased $6.5 million mainly due to a significant software sale.

- ♦ Moving to expenses, excluding license fees and adjustments, our fourth-quarter total expense increased 3 percent from the prior year to $290 million which is where we guided to last quarter. We had the normal sequential quarter expense increase this year, driven by marketing events, advertising, as well as project related fees.

- Our adjusted compensation related expense increased by less than 1 percent compared to last year and the compensation ratio in Q4 was 14.6 percent, down from 16.3 percent a year ago. In addition, the decline in our full year comp ratio had a similar trajectory.

- Looking at the non-operating income and expense line for the fourth quarter, our ownership in the S&P Dow Jones Indices joint venture drove $28 million in net earnings from unconsolidated subsidiaries – up 12 percent from Q4 last year. The compound annual growth rate on this contribution has been 13 percent since 2013.

- Turning to investment income, we received $3.7 million in dividends from BM&FBovespa. In addition, our investment returns, generated through the reinvestment of cash performance bonds and guaranty fund contributions, increased sequentially to $8.4 million from $7.3 million in Q3.

- Taxes for the fourth quarter were an adjusted 35.6 percent and were 36.2 percent for the full year.

- And now to the balance sheet – At the end of the fourth quarter, we had approximately $1.95 billion in cash and restricted cash. We returned approximately $1.1 billion of that with our annual variable dividend of $3.25 per share in January. In 2016, we returned $1.8 billion of dividends to our shareholders. During January, we sold down the remainder of our equity stake in BM&FBovespa. The total net proceeds are expected to be approximately $240 million. We will continue our strong and strategic relationship with them, and we have each decided that joint equity ownership is not required.

- During the fourth quarter, capital expenditures, net of leasehold improvement allowances were $33 million, bringing the full year to $92 million. Overall, our annual spend is lower than previous years, partly because of our asset light strategy of eliminating real estate, and in 2016, selling our data center. From a capital perspective, we are primarily focused on our technology and clearing services and we have invested approximately $12 million more in those activities in 2016 than last year. In terms of guidance for next year, we expect CAPEX to come in between $100 and $110 million.

- Turning to operating expenses. We will continue to be as efficient as possible as we execute on our strategy. For 2016, we guided to and achieved only a 1 percent increase in adjusted expenses excluding license fees and we expect to do the same in 2017. We anticipate adjusted total expense growth of approximately 1 percent to $1.09 billion excluding license fees in 2017. Included in the guidance are investments in organic market data growth, and new product extensions and offerings.

- Now to market data, as Bryan mentioned last quarter we have been doing a comprehensive review of our data business and the opportunity to expand beyond our traditional screen based real time offering. Our plan is to increase the data sales team focused on derived data, offer new services, such as our cloud-based data platform which enables us to easily add new data content and also build out an audit function. We expect to see approximately 5 to 6 percent organic revenue growth over the next few years, with 2017 being back end loaded.

- Finally, excluding any federal tax changes, we expect our tax rate next year to be approximately the same as this year at 36.3 percent.

- In summary, for the year, our revenue was up nearly $270 million, and our incremental operating margin was 92 percent; without license fees that jumps to about 96 percent. Our secular growth drivers continue to deliver results, our efficiency on expenses has been excellent and we are excited about the prospects ahead.

- 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 in 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; 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.*