

## CME Group Inc

## 1Q23E – Strong quarterly results but tough comps in 2Q/3Q23

Reiterate Rating: UNDERPERFORM | PO: 160.00 USD | Price: 184.93 USD

## CME reports strong results but 2Q23 outlook is softer

CME Group (CME) topped consensus estimates by 3%, reporting \$2.42 vs. consensus of \$2.35 and BofAe of \$2.34. The beat was mainly driven by better than expected pricing and clearinghouse-related income. Earlier this year, management had guided to a 4-5% increase in derivative RPC (starting Feb.) as well as a 4% increase in market data pricing (starting Jan.). So far, it appears that management is on track to exceed those targets on a net basis: equity & energy complex RPC are each up 10%+ q/q while market data revenues are 8% higher. Rates RPC was flat, but we attribute the fee headwinds to volume discounts and mix shifts in the quarter and expect improvements in 2Q23 pricing. After embedding these larger than expected price gains into our model, we are raising our 2023/24 EPS to \$8.67/\$8.77 from \$8.40/\$8.51 and PO to \$160 from \$156, still based on 17.5x our 2025E EPS. Reiterate Underperform.

## Clearinghouse income holding up

Although clearinghouse income fell roughly \$4M (2%) in the quarter, we had anticipated a steeper decline in light of the 11% drop in US futures margin balances. However, CME was able to better monetize its cash to help offset the decline. As volatility continues to normalize, we expect further declines in both balances and clearinghouse revenues going forward. That said, should the yield curve remain inverted, we may start to see clients shift their collateral from treasuries back into cash, which earns CME a higher fee.

## Excessive volatility stymies rates volumes QTD

On the back of the regional bank distress and uncertainty around Fed policy, the rates complex posted its strongest volumes on record, up 47% sequentially. However, we are seeing early signs of a reversal. Capital requirements have increased, while liquidity has declined, leading to a 42% q/q decline in rates volume and 33% decline in overall volume QTD. Additionally, since the Fed may soon go “on-hold” and quash speculation, we do not expect 1Q23 rates volume levels to be exceeded any time soon.

## Limited long-term growth prospects

Despite its premium valuation, CME has relatively small exposure to secular growth verticals and already has high market share in its mature markets. We anticipate lower growth for the futures market relative to other segments of the exchange ecosystem (e.g. fixed income e-trading, technology solutions, data, index). The exchange vertical also has less leverage to a market recovery than most other stocks under our coverage.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	6.69	7.97	8.67	8.77	9.14
GAAP EPS	6.69	7.97	8.67	8.77	9.14
EPS Change (YoY)	-0.6%	19.1%	8.8%	1.2%	4.2%
Consensus EPS (Bloomberg)			8.60	8.79	9.22
DPS	6.85	8.50	8.00	8.35	8.55
Valuation (Dec)					
P/E	27.6x	23.2x	21.3x	21.1x	20.2x
GAAP P/E	27.6x	23.2x	21.3x	21.1x	20.2x
Dividend Yield	3.7%	4.6%	4.3%	4.5%	4.6%

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Refer to important disclosures on page 6 to 8. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Timestamp: 26 April 2023 08:43PM EDT

26 April 2023

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	156.00	160.00
2023E Rev (m)	5,182.2	5,306.5
2024E Rev (m)	5,261.2	5,373.1
2025E Rev (m)	5,434.9	5,549.1
2023E EPS	8.40	8.67
2024E EPS	8.51	8.77
2025E EPS	8.89	9.14
2023E DPS	7.80	8.00

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## Stock Data

Price	184.93 USD
Price Objective	160.00 USD
Date Established	26-Apr-2023
Investment Opinion	B-3-7
52-Week Range	162.26 USD -222.52 USD
Mrkt Val / Shares Out (mn)	66,527 USD / 359.7
Average Daily Value	321.31 USD
BofA Ticker / Exchange	CME / NAS
Bloomberg / Reuters	CME US / CME.OQ
ROE (2023E)	11.5%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

RPC: Revenue per contract

ADV: Average daily volume

LIBOR: London Interbank Offered Rate

SOFR: Secured Overnight Financing Rate

# iQprofile<sup>SM</sup> CME Group Inc

Income Statement Data (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Total Net Revenue	4,687	5,019	5,307	5,373	5,549
% change	-4.0%	7.1%	5.7%	1.3%	3.3%
Compensation & Benefit	(784)	(746)	(779)	(802)	(822)
% change	-4.6%	-4.9%	4.4%	3.0%	2.5%
Non-Compensation Expenses	(921)	(1,026)	(1,048)	(1,051)	(1,065)
% change	-6.0%	11.5%	2.1%	0.4%	1.3%
Total Expenses	(1,705)	(1,772)	(1,826)	(1,853)	(1,886)
% change	-5.4%	4.0%	3.0%	1.5%	1.8%
Operating Income	2,982	3,247	3,480	3,520	3,663
% change	-3.3%	8.9%	7.2%	1.1%	4.1%
Reported Net Income	2,401	2,863	3,116	3,154	3,289
% change	-0.4%	19.2%	8.8%	1.2%	4.3%
Adjusted Net Income	2,400	2,863	3,117	3,154	3,289
% change	-0.5%	19.3%	8.9%	1.2%	4.3%

## Performance Metrics (Dec)

	2021A	2022A	2023E	2024E	2025E
Operating Margin	63.6%	64.7%	65.6%	65.5%	66.0%
Compensation Expense/Revenue	16.7%	14.9%	14.7%	14.9%	14.8%
Non-Compensation Expense/Revenue	19.6%	20.4%	19.7%	19.6%	19.2%
Dividend Payout Ratio	102.2%	106.5%	92.2%	95.1%	93.4%

## Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Assets	196,780	174,176	165,775	165,889	166,065
Cash and Investments	2,835	2,720	1,287	1,379	1,532
Long-Term Debt	2,696	3,422	3,423	3,423	3,423
Total Shareholders' Equity	27,399	26,879	27,120	27,234	27,411

## Company Sector

Other Financials

## Company Description

CME, which was founded in 1898, is a leading derivatives exchange that handles more than 90% of U.S. futures trading. The company owns and operates multiple regulated exchanges, including the CBOT, NYMEX, COMEX, and KCBT. CME has grown both organically and via acquisitions and offers products such as futures and options on futures across all major asset classes (interest rates, equity indexes, energy, FX, metals, agricultural commodities, etc.), market data and clearing services.

## Investment Rationale

CME stock is modestly overvalued relative to its long-term earnings growth and earnings quality. The current rebound in cyclical segments (rates, energy) are obscuring the tepid long-term growth rate of its largely mature businesses. The stock should trade more in line with its core peer group.

## Quarterly Earnings Estimates

	2022	2023
Q1	2.11A	2.42A
Q2	1.97A	2.04E
Q3	1.98A	2.11E
Q4	1.92A	2.09E

## Additional details

### Equity index sees competition from CBOE + international headwinds

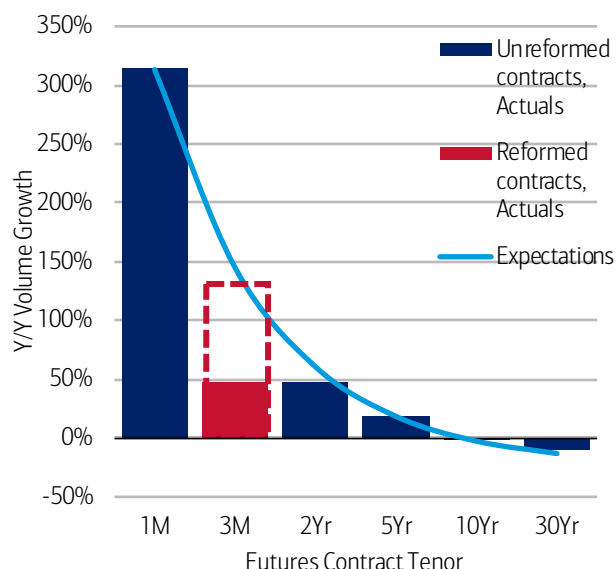
On the call, CME disputed that the equity index complex is experiencing competition from CBOE's zero-day options complex. Nevertheless, our channel checks with market makers indicate CBOE's options complex tends to be a cheaper way to delta hedge versus CME's equity e-minis. Additionally, there have been headwinds to the non-US equity complex (largely retail) with ADV trending down for four quarters. Overall, the equities complex volume was down 2% y/y in 1Q23, and given the persistence of headwinds, we are forecasting a 13% y/y decline in 2023.

### LIBOR transition update

On April 14, CME converted most of the remaining Eurodollar contracts and interest rate swaps to SOFR. As a result, CME will realize some lumpy swaps revenues in 2Q23 given the \$10/swap fee charged for the conversion, partially offset by the loss of est. 150k in LIBOR-SOFR spread trading ADV. Overall, CME has managed the US transition better than peers in other geographies, but the transition has still proved to be a drag on volumes. We note that reformed contracts have underperformed similar contracts (Exhibits 1 & 2), likely due to some volumes migrating toward swaps as well as operational complexity related to trading a new instrument. That said, with the transition nearing its conclusion, we believe this headwind is behind CME. Additionally, CME may have an opportunity to ramp licensing and market data revenues given its control of the Term SOFR benchmark, which has displaced LIBOR in much of the cash loan market.

#### Exhibit 1: Contract volume vs tenor

The SOFR transition appears to have put a damper on volumes



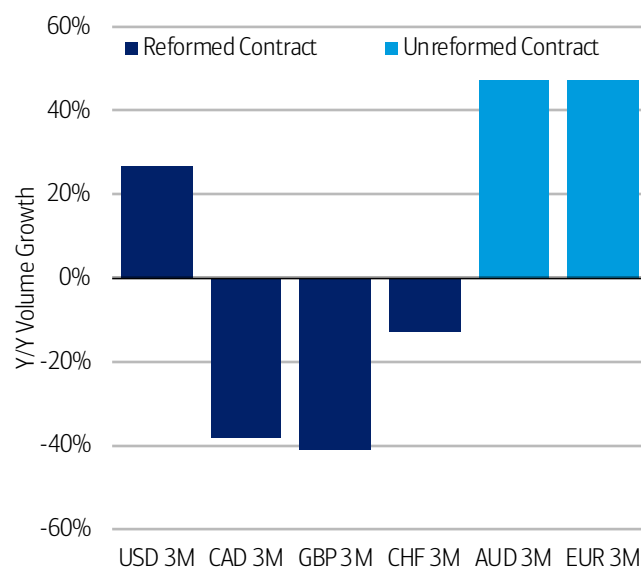
Source: Company reports, BofA Global Research

Notes: Y/Y growth refers to 2022 vs 2021 contract volumes

Reformed contract volume = Eurodollars + SOFR futures

#### Exhibit 2: Reformed vs unreformed 3M rate futures contract volumes

Unreformed contracts have had better volumes internationally



Source: FIA, Liquidnet, BofA Global Research

Notes: Y/Y growth refers to 2022 vs 2021 equivalent notional value

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## Price objective basis & risk

### CME Group Inc (CME)

Our primary valuation metric for US Exchanges is price to long-term earnings (2025E). We focus on long-term EPS because we prefer to normalize for any near-term factors, and it also provides credit for an additional two years of growth. We apply a 17.5x multiple on our 2025E EPS to derive our \$160 PO. Our multiple is based on the conservative assumption that CME trades in line with its peer group despite its lower growth prospects/earnings quality.

Downside risks are (1) depressed volumes, (2) lower earnings quality due to high transactional revenue composition, (3) mature markets and high market share stifling further growth, (4) trading at a premium to higher growth peers, (5) secular transition away from oil/fossil fuels where CME has high share and (6) regulatory risks (transaction tax, capital requirements).

Upside risks are (1) improving/elevated interest rate volumes due to quantitative tightening/inflation, (2) rebound in energy/metals volumes should there be a resolution in supply chain issues and the Russia/Ukraine conflict, (3) defensive qualities which drive stock outperformance in equity market drawdowns (e.g., 1Q22), and (4) potential for share gains in select markets: base metals after the LME debacle and cash after the DTCC cross-margining proposal is approved (estimated in 1Q23 versus 3Q22 prior target).

## Analyst Certification

I, Craig Siegenthaler, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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	Ares Management Corp	ARES	ARES US	Craig Siegenthaler, CFA
	BlackRock, Inc.	BLK	BLK US	Craig Siegenthaler, CFA
	Blackstone	BX	BX US	Craig Siegenthaler, CFA
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	Interactive Brokers	IBKR	IBKR US	Craig Siegenthaler, CFA
	Intercontinental Exchange	ICE	ICE US	Craig Siegenthaler, CFA
	KKR & Co. Inc.	KKR	KKR US	Craig Siegenthaler, CFA
	TPG Inc	TPG	TPG US	Craig Siegenthaler, CFA
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	AllianceBernstein	AB	AB US	Craig Siegenthaler, CFA
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	Invesco	IVZ	IVZ US	Craig Siegenthaler, CFA
	Janus Henderson Group	JHG	JHG US	Craig Siegenthaler, CFA
	Janus Henderson Group	JUHDY	JHG AU	Craig Siegenthaler, CFA
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	Patria	PAX	PAX US	Craig Siegenthaler, CFA
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	CME Group Inc	CME	CME US	Craig Siegenthaler, CFA
	Franklin Resources	BEN	BEN US	Craig Siegenthaler, CFA
	Nasdaq	NDAQ	NDAQ US	Craig Siegenthaler, CFA
	Robinhood Markets	HOOD	HOOD US	Craig Siegenthaler, CFA

## US - Brokers, Asset Managers, &amp; Exchanges Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	The Carlyle Group	CG	CG US	Craig Siegenthaler, CFA
<b>RSTR</b>	Focus Financial Partners	FOCS	FOCS US	Craig Siegenthaler, CFA

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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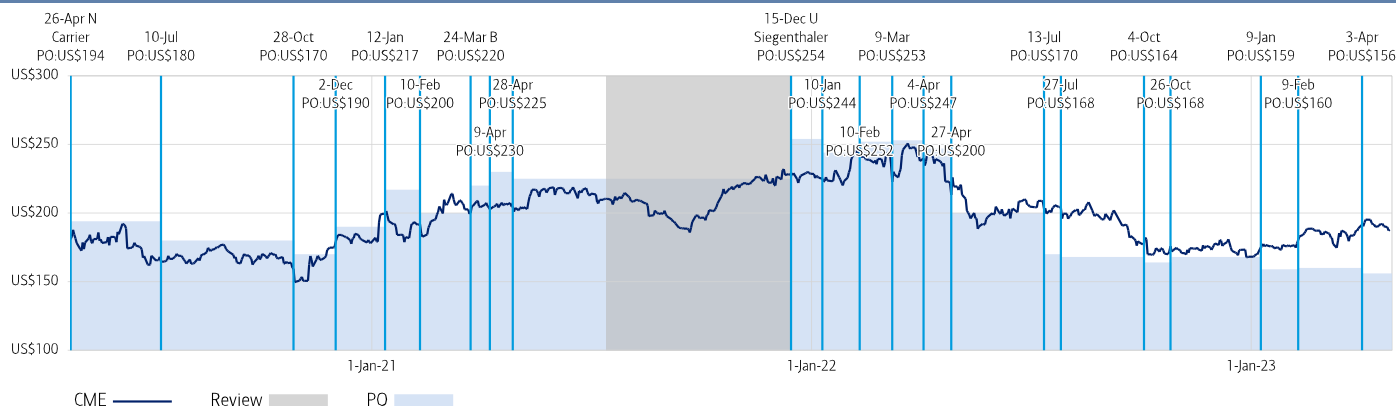
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B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Financial Services Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	152	52.41%	Buy	92	60.53%
Hold	73	25.17%	Hold	44	60.27%
Sell	65	22.41%	Sell	41	63.08%

### Equity Investment Rating Distribution: Global Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1869	53.01%	Buy	1030	55.11%
Hold	827	23.45%	Hold	476	57.56%
Sell	830	23.54%	Sell	389	46.87%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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