

## CME Group Inc

## 4Q23E – Positive quarter but expect deceleration in 2024

Reiterate Rating: NEUTRAL | PO: 215.00 USD | Price: 215.18 USD

## Positive 4Q23 results but expect a deceleration

Earlier today, CME Group (CME) reported higher than expected adjusted EPS driven by lower taxes and higher clearinghouse income. Expenses and op income missed while revenues were in-line. CME has been gradually losing market share in energy versus Intercontinental Exchange (ICE) since 2020, which we believe is due to a combination of energy price appreciation and margin optimization. On the call, CEO Terry Duffy attributed the market share erosion primarily to random quarterly fluctuations, but our channel checks suggest two reasons for the migration to ICE: (1) energy price appreciation and (2) elevated spread trading.

## Favorable macro for rates already embedded in volumes

4Q23 is being viewed by markets as a turning point in the global battle against inflation, and rates venues have been large beneficiaries. As we enter into a new chapter for monetary policy, rates traders have been actively repositioning their portfolios. CME's rates volumes were up 22% q/q and 36% y/y in 4Q23. Moreover, poor liquidity in cash markets have resulted in a favorable mix shift toward rates derivatives. However, given the strong results in 4Q23 and the downward movement in volatility QTD, we expect a deceleration in growth in the coming quarters.

## CME tones down price hikes; FMX potentially a factor

After pushing through the largest price increase in its history last year, CME is now backing off the pricing lever. It guided toward just a 1.5-2% y/y pricing tailwind for transaction fees, which is approximately half the size of both last year's hike and the rate of inflation. Inclusive of a 3-5% y/y hike in market data fees and a 43% hike in collateral fees, CME guided toward a 2.5-3% tailwind to group revenue from pricing in 2024. Notably, the transaction fee hikes do not touch the interest rate futures market, which will see a new entrant go live in 2024: BGC Group's FMX Futures Exchange. Our lower forecast for annual price increases moves our 2024/2025/2026 EPS estimates down to \$9.91/\$10.22/\$10.73 from \$10.07/\$10.42/\$11.06.

## Reiterate Neutral: Slowing growth x high valuation

Although we see modest upside to consensus volume estimates over the next few quarters due to the Fed pivot, CME's premium valuation (22x our 24E EPS) keeps us at Neutral. We do, however, raise our multiple from 17.5x to 20x 2026E EPS to embed a modest premium to lower-moat peers such as CBOE and NDAQ, which we value at 17.5x. Our price objective increases to \$215 from \$194, which implies ~4% total return potential.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	7.97	9.34	9.91	10.22	10.73
EPS Change (YoY)	19.1%	17.2%	6.1%	3.1%	5.0%
Consensus EPS (Bloomberg)			9.42	9.67	10.18
DPS	8.50	9.65	10.60	11.80	13.00
Valuation (Dec)					
P/E	27.0x	23.0x	21.7x	21.1x	20.1x
Dividend Yield	4.0%	4.5%	4.9%	5.5%	6.0%

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Timestamp: 14 February 2024 06:25PM EST

14 February 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	194.00	215.00
2024E Rev (m)	6,058.4	5,992.3
2025E Rev (m)	6,242.8	6,196.3
2026E Rev (m)	6,547.8	6,465.8
2024E EPS	10.07	9.91
2025E EPS	10.42	10.22
2026E EPS	11.06	10.73
2024E DPS	8.35	10.60

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## Stock Data

Price	215.18 USD
Price Objective	215.00 USD
Date Established	14-Feb-2024
Investment Opinion	B-2-7
52-Week Range	169.76 USD -219.09 USD
Mrkt Val / Shares Out (mn)	77,463 USD / 360.0
Free Float	99.5%
Average Daily Value	420.32 USD
BofA Ticker / Exchange	CME / NAS
Bloomberg / Reuters	CME US / CME.OQ
ROE (2024E)	13.4%
ESGMeter™	High

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

Income Statement Data (Dec)	2022A	2023A	2024E	2025E	2026E
(US\$ Millions)					
Total Net Revenue	5,019	5,579	5,992	6,196	6,466
% change	7.1%	11.1%	7.4%	3.4%	4.3%
Compensation & Benefit	(746)	(785)	(805)	(825)	(845)
% change	-4.9%	5.2%	2.5%	2.5%	2.5%
Non-Compensation Expenses	(1,026)	(1,063)	(1,092)	(1,135)	(1,156)
% change	11.5%	3.6%	2.7%	3.9%	1.9%
Total Expenses	(1,772)	(1,848)	(1,896)	(1,960)	(2,002)
% change	4.0%	4.3%	2.6%	3.3%	2.1%
Operating Income	3,247	3,731	4,096	4,237	4,464
% change	8.9%	14.9%	9.8%	3.4%	5.4%
Reported Net Income	2,863	3,358	3,571	3,691	3,884
% change	19.2%	17.3%	6.3%	3.4%	5.2%
Adjusted Net Income	2,863	3,359	3,571	3,691	3,884
% change	19.3%	17.3%	6.3%	3.4%	5.2%

## Performance Metrics (Dec)

	2022A	2023A	2024E	2025E	2026E
Operating Margin	64.7%	66.9%	68.4%	68.4%	69.0%
Compensation Expense/Revenue	14.9%	14.1%	13.4%	13.3%	13.1%
Non-Compensation Expense/Revenue	20.4%	19.1%	18.2%	18.3%	17.9%
Dividend Payout Ratio	106.5%	103.1%	106.9%	115.3%	121.0%

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Assets	174,176	129,706	129,412	128,789	128,789
Cash and Investments	2,720	2,912	2,589	1,938	1,938
Long-Term Debt	3,422	3,425	3,425	3,425	3,425
Total Shareholders' Equity	26,879	26,738	26,443	25,821	25,821

## 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

While we note that CME lacks the secular growth characteristics of other areas of the exchange universe (e.g. fixed income e-trading, index and data), we believe that the low VIX and CME's low valuation (versus history) creates upside risk for the stock. Pricing gains, retail expansion and the reduction of bad volatility could also benefit earnings over the intermediate term.

## Quarterly Earnings Estimates

	2023	2024
Q1	2.42A	2.48E
Q2	2.30A	2.46E
Q3	2.25A	2.53E
Q4	2.37A	2.45E

## Additional details

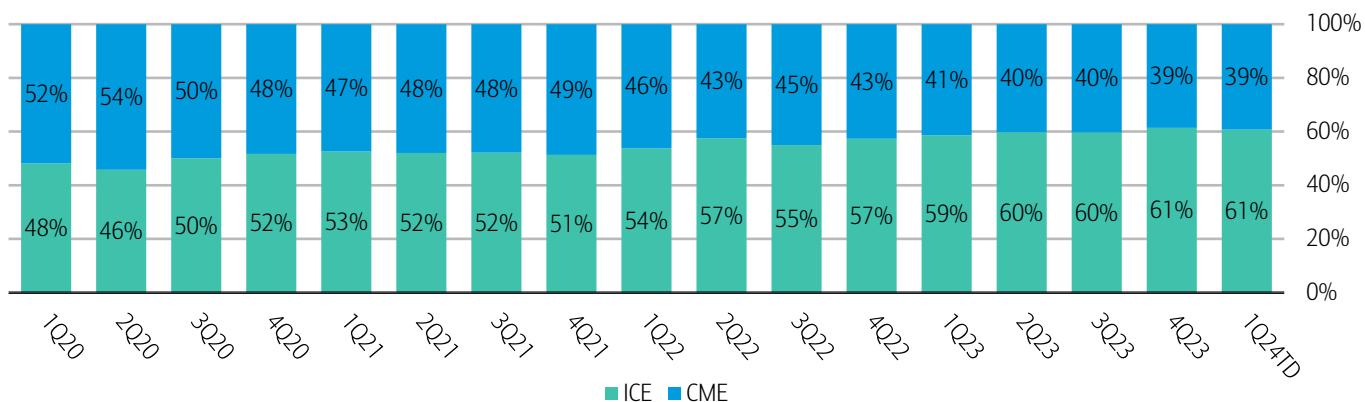
### Perspective on energy market share declines

CME has been gradually losing market share in energy versus Intercontinental Exchange (ICE) since 2020, which we believe is due to a combination of energy price appreciation and margin optimization. On the call, CEO Terry Duffy attributed the market share erosion primarily to random quarterly fluctuations, but our channel checks suggest two reasons for the migration to ICE:

- **Energy price appreciation:** Relative to the 2015-2021 period, energy prices have increased materially. Both natural gas and crude oil are 55-60% higher over the past three years. Historically, higher energy prices tend to disadvantage CME. CME has a higher proportion of financial participants than ICE. These financial participants can trade fewer contracts and still achieve the same notional exposure when commodity prices are higher. Meanwhile, ICE's commercial-heavy client base thinks of their exposure in terms of physical units, not dollars.
- **Elevated spread trading:** Our channel checks have indicated that there has been elevated levels of spread trading between WTI/Brent as well as between European Nat Gas/Henry Hub. This is likely due to the high amount of volatility in European energy markets over the past two years, which has presumably created arbitrage opportunities. Spread trades tend to be done on ICE since they have liquidity in both products and can therefore provide operational/capital efficiencies. The capital benefits of doing spread trades on ICE is particularly meaningful in the prevailing environment of higher interest rates.

### Exhibit 1: Crude oil futures market share estimates

CME has lost 1,300 bps of market share in three years

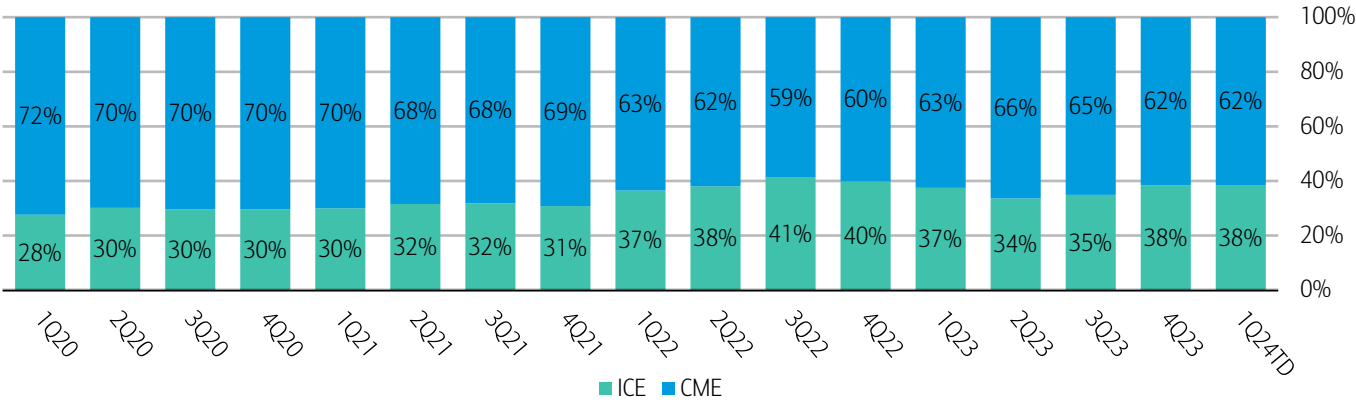


Source: Company reports, BofA Global Research

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**Exhibit 2: US natural gas market share estimates**  
CME has lost 1,000 bps of market share in three years



Source: Company reports, BofA Global Research

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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 (2026E). 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 20x multiple on our 2026E EPS to derive our \$215 PO. Our multiple is based on the conservative assumption that CME trades in line with its higher-growth peer.

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 and (5) secular transition away from oil/fossil fuels where CME has high share.

Upside risks are (1) improving/elevated interest rate volumes due to quantitative tightening/inflation, (2) defensive qualities which drive stock outperformance in equity market drawdowns (e.g., 1Q22), (3) futures rollouts on additional retail brokerages, and (4) potential for share gains in select markets: base metals after the LME debacle and cash after the recent DTCC cross-margining agreement.

## 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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	Ameriprise Financial	AMP	AMP US	Craig Siegenthaler, CFA
	Ares Management Corp	ARES	ARES US	Craig Siegenthaler, CFA
	BlackRock, Inc.	BLK	BLK US	Craig Siegenthaler, CFA
	Blackstone	BX	BX US	Craig Siegenthaler, CFA
	Blue Owl Capital	OWL	OWL US	Craig Siegenthaler, CFA
	Cboe Global Markets	CBOE	CBOE US	Craig Siegenthaler, CFA
	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
	Raymond James Financial	RJF	RJF US	Mark McLaughlin, CFA
	TPG Inc	TPG	TPG US	Craig Siegenthaler, CFA
	Tradeweb Markets Inc.	TW	TW US	Craig Siegenthaler, CFA
	Victory Capital Holdings, Inc.	VCTR	VCTR US	Craig Siegenthaler, CFA
	Virtu Financial	VIRT	VIRT US	Craig Siegenthaler, CFA
<b>NEUTRAL</b>				
	Affiliated Managers Group	AMG	AMG US	Craig Siegenthaler, CFA
	Apollo Global Management	APO	APO US	Craig Siegenthaler, CFA
	Brookfield Asset Management	BAM	BAM US	Craig Siegenthaler, CFA
	CME Group Inc	CME	CME US	Craig Siegenthaler, CFA
	Invesco	IVZ	IVZ US	Craig Siegenthaler, CFA
	Janus Henderson Group	JHG	JHG US	Craig Siegenthaler, CFA
	LPL Financial Holdings	LPLA	LPLA US	Craig Siegenthaler, CFA
	Patria	PAX	PAX US	Craig Siegenthaler, CFA
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	Franklin Resources	BEN	BEN US	Craig Siegenthaler, CFA
	Nasdaq	NDAQ	NDAQ US	Craig Siegenthaler, CFA
	Robinhood Markets	HOOD	HOOD US	Craig Siegenthaler, CFA
	T. Rowe Price	TROW	TROW US	Craig Siegenthaler, CFA



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

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	The Carlyle Group	CG	CG 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

**Quality of Earnings**

Cash Realization Ratio  
Asset Replacement Ratio  
Tax Rate  
Net Debt-To-Equity Ratio  
Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio  
Price / Book Value  
Dividend Yield  
Free Cash Flow Yield  
Enterprise Value / Sales

EV / EBITDA

**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

**Numerator**

Cash Flow From Operations  
Capex  
Tax Charge  
Net Debt = Total Debt – Cash & Equivalents  
EBIT

**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**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill  
Amortization  
Shareholders' Equity  
Sales  
N/A  
N/A

**Denominator**

Net Income  
Depreciation  
Pre-Tax Income  
Total Equity  
Interest Expense

**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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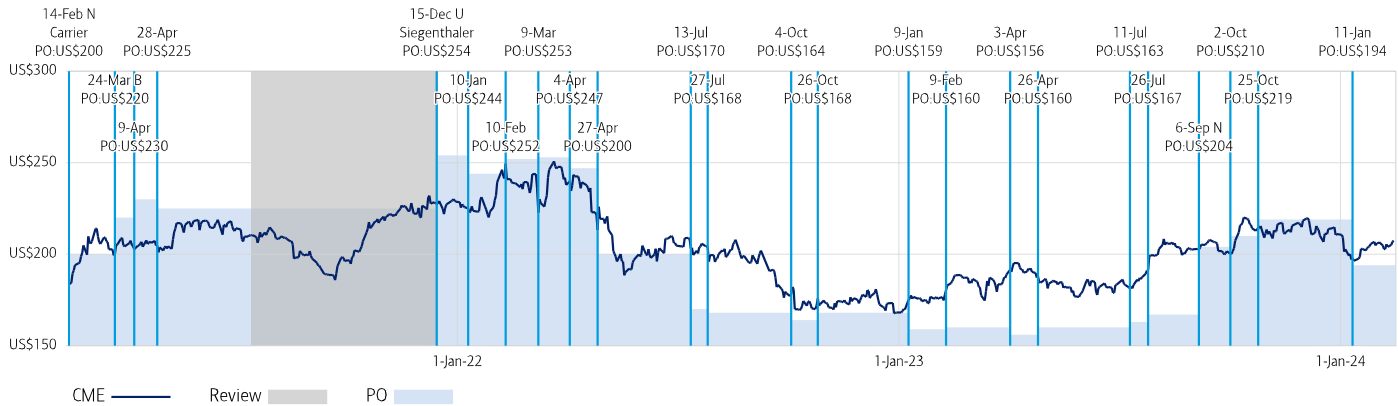
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### CME Group Inc (CME) Price Chart



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 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<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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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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