

CME Group Inc

2Q23 Earnings – Profit beat on June RPC strength + clearinghouse revenues

Reiterate Rating: UNDERPERFORM | PO: 167.00 USD | Price: 191.22 USD

CME beats on June RPC strength and clearinghouse revs

CME Group (CME) topped consensus estimates by 6%, reporting \$2.30 vs. consensus of \$2.17 and BofAe of \$2.20. The beat was mainly driven by better than expected June RPC and clearinghouse-related income. The increase in June RPC was primarily driven by favorable mix shifts whereas clearinghouse revenue benefitted from higher open interest (equities) and margin requirements (rates and equity index).

Increasing EPS on both expenses and volumes

We raised our EPS estimates for 2023/2024/2025 to \$9.22/\$9.42/\$9.53 from \$9.08/\$9.19/\$9.32 after modest revisions to our expense and volume estimates. We slightly reduced our compensation expense forecast in light of softer merit increases and the recent headcount reduction. Meanwhile, we increased our volume forecast for rates/equity index modestly in 2H23 given expected seasonality and a normalization in market quality and capital requirements. Our PO increases to \$167 from \$163.

Rates tailwinds from new clearing efficiencies

We expect the SEC treasury central clearing proposal and the new DTCC cross-margining arrangement to benefit rates volumes from 2024 onward. CME and the DTCC have finalized a new agreement designed to reduce margin requirements for traders who play in both cash rates and derivatives. The agreement encompasses more products (e.g. SOFR futures, ultra treasury futures, repos) than the existing arrangement, and it will take effect in 1Q24 pending regulatory approval. CME estimates that it will more than double the amount of cash-derivative margin offsets. We think the SEC's pending treasury central clearing rule proposal will amplify these clearing efficiencies by forcing more traders into the DTCC.

Reiterate Underperform; Limited '24-'25 growth potential

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 the other industries under our coverage – especially given the strong volume levels in 2022-1Q23.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	6.69	7.97	9.22	9.42	9.53
GAAP EPS	6.69	7.97	9.22	9.42	9.53
EPS Change (YoY)	-0.6%	19.1%	15.7%	2.2%	1.2%
Consensus EPS (Bloomberg)			8.84	8.99	9.36
DPS	6.85	8.50	8.00	8.35	8.55
Valuation (Dec)					
P/E	28.6x	24.0x	20.7x	20.3x	20.1x
GAAP P/E	28.6x	24.0x	20.7x	20.3x	20.1x
Dividend Yield	3.6%	4.4%	4.2%	4.4%	4.5%

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26 July 2023

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	163.00	167.00
2023E Rev (m)	5,519.0	5,513.0
2024E Rev (m)	5,621.1	5,678.7
2025E Rev (m)	5,702.8	5,759.8
2023E EPS	9.08	9.22
2024E EPS	9.19	9.42
2025E EPS	9.32	9.53

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Stock Data

Price	191.22 USD
Price Objective	167.00 USD
Date Established	26-Jul-2023
Investment Opinion	B-3-7
52-Week Range	162.26 USD -203.81 USD
Mkt Val / Shares Out (mn)	68,785 USD / 359.7
Average Daily Value	294.19 USD
BofA Ticker / Exchange	CME / NAS
Bloomberg / Reuters	CME US / CME.OQ
ROE (2023E)	12.2%
ESGMeter™	High

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iQprofileSM CME Group Inc

Income Statement Data (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Total Net Revenue	4,687	5,019	5,513	5,679	5,760
% change	-4.0%	7.1%	9.8%	3.0%	1.4%
Compensation & Benefit	(784)	(746)	(768)	(799)	(823)
% change	-4.6%	-4.9%	3.0%	4.0%	3.0%
Non-Compensation Expenses	(921)	(1,026)	(1,064)	(1,106)	(1,147)
% change	-6.0%	11.5%	3.6%	4.0%	3.7%
Total Expenses	(1,705)	(1,772)	(1,832)	(1,905)	(1,970)
% change	-5.4%	4.0%	3.4%	4.0%	3.4%
Operating Income	2,982	3,247	3,681	3,774	3,790
% change	-3.3%	8.9%	13.4%	2.5%	0.4%
Reported Net Income	2,401	2,863	3,314	3,386	3,425
% change	-0.4%	19.2%	15.7%	2.2%	1.2%
Adjusted Net Income	2,400	2,863	3,312	3,386	3,425
% change	-0.5%	19.3%	15.7%	2.2%	1.2%

Performance Metrics (Dec)

	2021A	2022A	2023E	2024E	2025E
Operating Margin	63.6%	64.7%	66.8%	66.5%	65.8%
Compensation Expense/Revenue	16.7%	14.9%	13.9%	14.1%	14.3%
Non-Compensation Expense/Revenue	19.6%	20.4%	19.3%	19.5%	19.9%
Dividend Payout Ratio	102.2%	106.5%	86.7%	88.5%	89.6%

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Total Assets	196,780	174,176	150,803	151,155	151,472
Cash and Investments	2,835	2,720	1,378	1,704	1,996
Long-Term Debt	2,696	3,422	3,424	3,424	3,424
Total Shareholders' Equity	27,399	26,879	27,324	27,676	27,993

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	2.30E
Q3	1.98A	2.26E
Q4	1.92A	2.23E

Additional details

Relative strength in commodity futures given margins, price and catalysts

Despite negative seasonality in the second quarter, energy and agriculture futures volumes were robust in 2Q23, which we attribute to lower collateral levels and macro factors. In energy, CME volumes were up 9% and flattish sequentially. Meanwhile, in agriculture, CME was up 34% y/y and 27% q/q. We note that margin levels have continued to decline across key commodities, which has lowered the all-in cost to trade. Additionally, the decline in energy prices has forced financial players to trade more contracts in order to achieve the same notional exposure. The average WTI/Brent and Henry Hub price has fallen 2%/5% and 15% sequentially, respectively. Finally, the Ukrainian grain deal, OPEC, Iranian nuclear negotiations, and El Nino have all been meaningful catalysts for trading in the quarter.

Financial futures normalized down sequentially but expect growth by 4Q23

CME's financial futures complex (rates & equities) saw volatility-related headwinds in 2Q23, but we expect ADV growth to resume by 4Q23. There were multiple sequential headwinds to financial futures volumes in 2Q23 including: (1) negative seasonality, (2) a decline in implied volatility, (3) share losses to CBOE in equity index, and (4) repercussions from 1Q23's regional bank distress. Not only is trading activity normalizing downward in financial futures, but the regional bank distress also increased capital requirements in equity and rates futures by about 5-10% in 2Q23. Going forward, we are forecasting a modest 2% seasonal decline in financial futures ADV in 3Q23 followed by a 3% q/q increase in 4Q23. Longer term, a pick-up in treasury coupon issuance and ongoing quantitative tightening should increase the number of hedgeable bonds, supporting rates derivative volume.



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 \$167 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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Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	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
	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
	Tradeweb Markets Inc.	TW	TW US	Craig Siegenthaler, CFA
	Victory Capital Holdings, Inc.	VCTR	VCTR US	Craig Siegenthaler, CFA
NEUTRAL				
	Affiliated Managers Group	AMG	AMG US	Craig Siegenthaler, CFA
	AllianceBernstein	AB	AB US	Craig Siegenthaler, CFA
	Apollo Global Management	APO	APO US	Craig Siegenthaler, CFA
	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
UNDERPERFORM				
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	Franklin Resources	BEN	BEN US	Craig Siegenthaler, CFA
	Nasdaq	NDAQ	NDAQ US	Craig Siegenthaler, CFA

US - Brokers, Asset Managers, & Exchanges Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Robinhood Markets	HOOD	HOOD US	Craig Siegenthaler, CFA
	T. Rowe Price	TROW	TROW US	Craig Siegenthaler, CFA
	The Carlyle Group	CG	CG US	Craig Siegenthaler, CFA
RSTR				
	Focus Financial Partners	FOCS	FOCS US	Craig Siegenthaler, CFA

IQmethodSM 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

DenominatorTotal 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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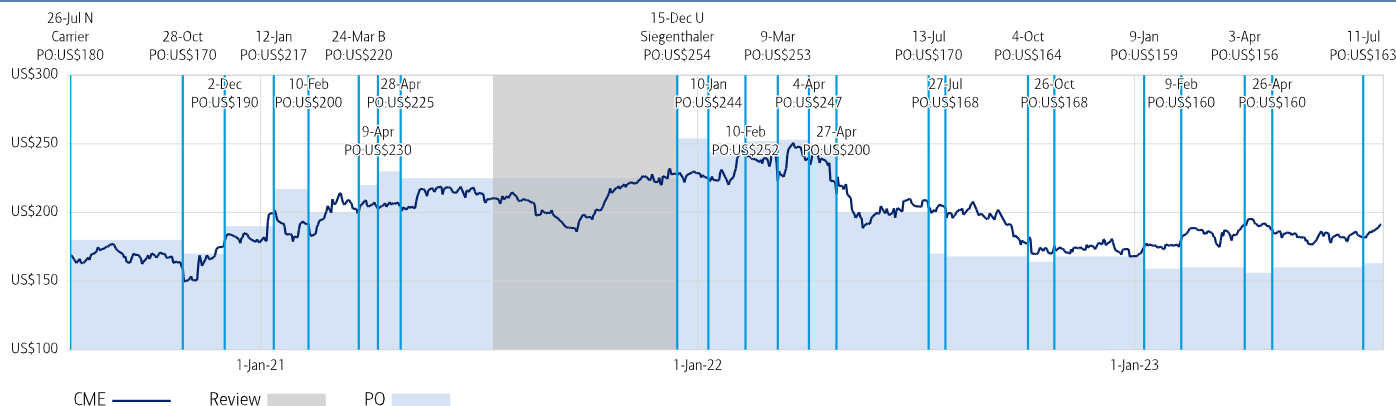
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CME Group Inc (CME) Price Chart



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 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	145	50.52%	Buy	91	62.76%
Hold	78	27.18%	Hold	47	60.26%
Sell	64	22.30%	Sell	38	59.38%

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{R1} 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 ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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