

CME GROUP INC.
Form 10-Q
May 04, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2016

- OR -

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 001-31553

CME GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware 36-4459170

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

20 South Wacker Drive, Chicago, Illinois 60606
(Address of principal executive offices) (Zip Code)
(312) 930-1000

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The number of shares outstanding of each of the registrant's classes of common stock as of April 13, 2016 was as follows: 338,639,819 shares of Class A common stock, \$0.01 par value; 625 shares of Class B-1 common stock, \$0.01 par value; 813 shares of Class B-2 common stock, \$0.01 par value; 1,287 shares of Class B-3 common stock, \$0.01

par value; and 413 shares of Class B-4 common stock, \$0.01 par value.

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PART I. FINANCIAL INFORMATION

Certain Terms

Unless otherwise indicated, references to CME Group Inc. (CME Group or the company) products include references to products listed on one of its regulated exchanges: Chicago Mercantile Exchange Inc. (CME), Board of Trade of the City of Chicago, Inc. (CBOT), New York Mercantile Exchange, Inc. (NYMEX) and Commodity Exchange, Inc. (COMEX). Products listed on these exchanges are subject to the rules and regulations of the particular exchange and the applicable rulebook should be consulted. Unless otherwise indicated, references to NYMEX include its subsidiary, COMEX.

All references to “options” or “options contracts” in the text of this document refer to options on futures contracts.

Further information about CME Group and its products can be found at <http://www.cmegroup.com>. Information made available on our website does not constitute a part of this Quarterly Report on Form 10-Q.

Information about Contract Volume and Average Rate per Contract

All amounts regarding contract volume and average rate per contract exclude our interest rate swaps and credit default swaps contracts.

Trademark Information

CME Group is a trademark of CME Group Inc. The Globe logo, CME, Chicago Mercantile Exchange, Globex and E-mini are trademarks of Chicago Mercantile Exchange Inc. CBOT, Chicago Board of Trade, KCBT and Kansas City Board of Trade are trademarks of Board of Trade of the City of Chicago, Inc. NYMEX, New York Mercantile Exchange and ClearPort are trademarks of New York Mercantile Exchange, Inc. COMEX is a trademark of Commodity Exchange, Inc. Dow Jones, Dow Jones Industrial Average, S&P 500 and S&P are service and/or trademarks of Dow Jones Trademark Holdings LLC, Standard & Poor's Financial Services LLC and S&P/Dow Jones Indices LLC, as the case may be, and have been licensed for use by Chicago Mercantile Exchange Inc. All other trademarks are the property of their respective owners.

Forward-Looking Statements

From time to time, in this Quarterly Report on Form 10-Q as well as in other written reports and verbal statements, we discuss our expectations regarding future performance. These forward-looking statements are identified by their use of terms and phrases such as “believe,” “anticipate,” “could,” “estimate,” “intend,” “may,” “plan,” “expect” and similar expressions, including references to assumptions. These forward-looking statements are based on currently available competitive, financial and economic data, current expectations, estimates, forecasts and projections about the industries in which we operate and management's beliefs and assumptions. 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;

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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 Item 1A. of our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on February 26, 2016 and Item 1A. of this Quarterly Report on Form 10-Q.

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ITEM 1. FINANCIAL STATEMENTS

CME GROUP INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in millions, except par value data; shares in thousands)

(unaudited)

	March 31, 2016	December 31, 2015
Assets		
Current Assets:		
Cash and cash equivalents	\$1,146.0	\$ 1,692.6
Marketable securities	79.2	72.5
Accounts receivable, net of allowance of \$3.7 and \$1.9	389.3	357.8
Other current assets (includes \$32.0 in restricted cash in both periods)	141.5	228.6
Performance bonds and guaranty fund contributions	37,497.3	35,553.0
Total current assets	39,253.3	37,904.5
Property, net of accumulated depreciation and amortization of \$680.6 and \$788.6	449.8	491.7
Intangible assets—trading products	17,175.3	17,175.3
Intangible assets—other, net	2,513.9	2,537.9
Goodwill	7,569.0	7,569.0
Other assets (includes \$69.1 and \$70.5 in restricted cash)	1,806.9	1,681.0
Total Assets	\$68,768.2	\$ 67,359.4
Liabilities and Equity		
Current Liabilities:		
Accounts payable	\$32.2	\$ 28.7
Other current liabilities	321.6	1,242.8
Performance bonds and guaranty fund contributions	37,494.3	35,553.0
Total current liabilities	37,848.1	36,824.5
Long-term debt	2,229.8	2,229.3
Deferred income tax liabilities, net	7,330.8	7,358.3
Other liabilities	518.1	395.5
Total Liabilities	47,926.8	46,807.6
Shareholders' Equity:		
Preferred stock, \$0.01 par value, 10,000 shares authorized at March 31, 2016 and December 31, 2015; none issued	—	—
Class A common stock, \$0.01 par value, 1,000,000 shares authorized at March 31, 2016 and December 31, 2015; 337,216 and 336,938 shares issued and outstanding as of March 31, 2016 and December 31, 2015, respectively	3.4	3.4
Class B common stock, \$0.01 par value, 3 shares authorized, issued and outstanding as of March 31, 2016 and December 31, 2015	—	—
Additional paid-in capital	17,737.6	17,721.6
Retained earnings	3,072.3	2,907.6
Accumulated other comprehensive income (loss)	28.1	(80.8)
Total shareholders' equity	20,841.4	20,551.8
Total Liabilities and Equity	\$68,768.2	\$ 67,359.4

See accompanying notes to unaudited consolidated financial statements.

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CME GROUP INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(dollars in millions, except per share data; shares in thousands)

(unaudited)

	Quarter Ended March 31,	
	2016	2015
Revenues		
Clearing and transaction fees	\$796.1	\$708.2
Market data and information services	102.4	98.0
Access and communication fees	21.6	21.3
Other	14.1	15.2
Total Revenues	934.2	842.7
Expenses		
Compensation and benefits	131.9	141.3
Communications	6.7	7.6
Technology support services	17.4	15.6
Professional fees and outside services	31.7	29.1
Amortization of purchased intangibles	24.0	24.9
Depreciation and amortization	33.9	31.8
Occupancy and building operations	21.3	22.8
Licensing and other fee agreements	39.0	30.6
Other	54.4	31.7
Total Expenses	360.3	335.4
Operating Income	573.9	507.3
Non-Operating Income (Expense)		
Investment income	17.6	5.7
Gains (losses) on derivative investments	—	(1.8)
Interest and other borrowing costs	(29.8)	(31.6)
Equity in net earnings (losses) of unconsolidated subsidiaries	26.8	22.5
Other non-operating income (expense)	(10.0)	21.7
Total Non-Operating	4.6	16.5
Income before Income Taxes	578.5	523.8
Income tax provision	210.7	193.4
Net Income	\$367.8	\$330.4
Earnings per Common Share:		
Basic	\$1.09	\$0.98
Diluted	1.09	0.98
Weighted Average Number of Common Shares:		
Basic	337,014	335,680
Diluted	338,549	337,416
See accompanying notes to unaudited consolidated financial statements.		

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CME GROUP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in millions)
(unaudited)

	Quarter Ended March 31,	
	2016	2015
Net income	\$367.8	\$330.4
Other comprehensive income (loss), net of tax:		
Investment securities:		
Net unrealized holding gains (losses) arising during the period	109.6	(27.7)
Income tax benefit (expense)	(0.8)	—
Investment securities, net	108.8	(27.7)
Defined benefit plans:		
Net change in defined benefit plans arising during the period	3.1	(0.3)
Amortization of net actuarial (gains) losses included in compensation and benefits expense	0.8	0.7
Income tax benefit (expense)	(1.5)	(0.2)
Defined benefit plans, net	2.4	0.2
Derivative investments:		
Net unrealized holding gains (losses) arising during the period	—	(4.7)
Ineffectiveness on cash flow hedges included in (gains) losses on derivative investments	—	1.8
Amortization of effective portion of net (gains) losses on cash flow hedges included in interest expense	(0.3)	(0.3)
Income tax benefit (expense)	0.1	1.2
Derivative investments, net	(0.2)	(2.0)
Foreign currency translation:		
Foreign currency translation adjustments	(3.3)	(4.0)
Income tax benefit (expense)	1.2	1.5
Foreign currency translation, net	(2.1)	(2.5)
Other comprehensive income (loss), net of tax	108.9	(32.0)
Comprehensive Income	\$476.7	\$298.4
See accompanying notes to unaudited consolidated financial statements.		

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CONSOLIDATED STATEMENTS OF EQUITY(dollars in millions, except per share data; shares in thousands)
(unaudited)

	Class A Common Stock (Shares)	Class B Common Stock (Shares)	Common Stock and Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2015	336,938	3	\$17,725.0	\$2,907.6	\$ (80.8)	\$20,551.8
Net income				367.8		367.8
Other comprehensive income (loss) attributable to CME Group					108.9	108.9
Dividends on common stock of \$0.60 per share				(203.1)		(203.1)
Exercise of stock options	102		6.4			6.4
Excess tax benefits from option exercises and restricted stock vesting			3.9			3.9
Vesting of issued restricted Class A common stock	176		(10.3)			(10.3)
Stock-based compensation			16.0			16.0
Balance at March 31, 2016	337,216	3	\$17,741.0	\$3,072.3	\$ 28.1	\$20,841.4
See accompanying notes to unaudited consolidated financial statements.						

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CME GROUP INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY (continued)

(dollars in millions, except per share data; shares in thousands)

(unaudited)

	Class A Common Stock (Shares)	Class B Common Stock (Shares)	Common Stock and Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2014	335,452	3	\$17,600.0	\$3,317.3	\$ 6.2	\$ 20,923.5
Net income				330.4		330.4
Other comprehensive income (loss) attributable to CME Group					(32.0)	(32.0)
Dividends on common stock of \$0.50 per share				(168.4)		(168.4)
Exercise of stock options	436		28.6			28.6
Excess tax benefits from option exercises and restricted stock vesting			0.7			0.7
Vesting of issued restricted Class A common stock	40		(2.0)			(2.0)
Stock-based compensation			14.7			14.7
Balance at March 31, 2015	335,928	3	\$17,642.0	\$3,479.3	\$ (25.8)	\$ 21,095.5

See accompanying notes to unaudited consolidated financial statements.

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CME GROUP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(unaudited)

	Quarter Ended March 31,	
	2016	2015
Cash Flows from Operating Activities		
Net income	\$367.8	\$330.4
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	16.0	14.7
Amortization of purchased intangibles	24.0	24.9
Depreciation and amortization	33.9	31.8
Loss on datacenter	27.1	—
Undistributed earnings, net of losses, of unconsolidated subsidiaries	4.2	3.3
Deferred income taxes	(0.4)	) 0.5
Change in:		
Accounts receivable	(33.3)	) (41.8)
Other current assets	(0.1)	) 4.9
Other assets	(5.9)	) (11.2)
Accounts payable	3.5	(3.0)
Income taxes payable	178.5	149.1
Other current liabilities	(88.1)	) (85.4)
Other liabilities	(7.5)	) (1.9)
Other	—	2.6
Net Cash Provided by Operating Activities	519.7	418.9
Cash Flows from Investing Activities		
Proceeds from maturities of available-for-sale marketable securities	31.8	10.2
Purchases of available-for-sale marketable securities	(35.9)	) (10.2)
Purchases of property, net	(20.2)	) (31.4)
Investments in business ventures	(3.0)) —
Settlement of derivative related to debt issuance	—	7.0
Net Cash Used in Investing Activities	(27.3)	) (24.4)
Cash Flows from Financing Activities		
Proceeds from debt, net of issuance costs	—	743.7
Cash dividends	(1,179.3)	) (838.8)
Proceeds from finance lease obligation	130.0	—
Proceeds from exercise of stock options	6.4	28.6
Excess tax benefits related to employee option exercises and restricted stock vesting	3.9	0.7
Net Cash Used in Financing Activities	(1,039.0)	) (65.8)
Net change in cash and cash equivalents	(546.6)	) 328.7
Cash and cash equivalents, beginning of period	1,692.6	1,366.1
Cash and Cash Equivalents, End of Period	\$1,146.0	\$1,694.8
Supplemental Disclosure of Cash Flow Information		
Income taxes paid	\$28.1	\$43.9

Interest paid	42.4	44.6
See accompanying notes to unaudited consolidated financial statements.		

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The consolidated financial statements consist of CME Group Inc. (CME Group) and its subsidiaries (collectively, the company), including Chicago Mercantile Exchange Inc. (CME), Board of Trade of the City of Chicago, Inc. (CBOT), New York Mercantile Exchange, Inc. (NYMEX), Commodity Exchange, Inc. (COMEX), CME Clearing Europe Limited (CMECE) and CME Europe Limited (CME Europe). CME, CBOT, NYMEX, COMEX, CMECE and CME Europe and their subsidiaries are referred to collectively as “the exchange” in the notes to the consolidated financial statements. The clearing houses include CME Clearing, which is the U.S. clearing house and a division of CME, and CMECE.

The accompanying interim consolidated financial statements have been prepared by CME Group without audit. Certain notes and other information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. In the opinion of management, the accompanying consolidated financial statements include all normal recurring adjustments considered necessary to present fairly the financial position of the company at March 31, 2016 and December 31, 2015 and the results of operations and cash flows for the periods indicated. Quarterly results are not necessarily indicative of results for any subsequent period.

The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in CME Group’s Annual Report on Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission (SEC) on February 26, 2016.

2. Performance Bonds and Guaranty Fund Contributions

Performance Bonds and Guaranty Fund Contributions. At March 31, 2016, performance bonds and guaranty fund contribution assets on the consolidated balance sheets include cash and U.S. Treasury securities with maturity dates of 90 days or less. U.S. Treasury securities are purchased by CME, at its discretion, using cash collateral. The benefits, including interest earned, and risks of ownership accrue to CME. Interest earned is included in investment income on the consolidated statements of income. These securities are classified as available-for-sale. At March 31, 2016, the amortized cost and fair value of the U.S. Treasury securities was \$10,247.6 million and \$10,248.7 million, respectively. The original cost of these U.S. Treasury securities was \$10,245.7 million. The U.S. Treasury securities will mature in the second quarter of 2016. Performance bonds and guaranty fund contribution assets also include overnight reverse repurchase agreements that were purchased by CME, at its discretion, using cash collateral. The fair value of the overnight securities under the reverse repurchase agreements was \$3.0 billion at March 31, 2016. CME has been designated as a systemically important financial market utility by the Financial Stability Oversight Council and is authorized to establish and maintain a cash account at the Federal Reserve Bank of Chicago. This account is expected to be opened in the second quarter of 2016 and CME will be able to begin holding cash collateral at the Federal Reserve Bank of Chicago.

Clearing House Contract Settlement. CME Clearing and CMECE mark-to-market open positions for all futures and options contracts twice a day (once a day for CME’s cleared-only credit default swap and interest rate swap contracts). Based on values derived from the mark-to-market process, CME Clearing and CMECE require payments from clearing firms whose positions have lost value and make payments to clearing firms whose positions have gained value. Under the extremely unlikely scenario of simultaneous default by every clearing firm who has open positions with unrealized losses, the maximum exposure related to positions other than cleared-only credit default and interest rate swap contracts would be one half day of changes in fair value of all open positions, before considering the clearing houses’ ability to access defaulting clearing firms’ collateral deposits. For CME’s cleared-only credit default swap and interest rate swap contracts, the maximum exposure related to CME Clearing’s guarantee would be one full day of changes in fair value of all open positions, before considering CME Clearing’s ability to access defaulting clearing firms’ collateral. During the first quarter of 2016, CME Clearing and CMECE transferred an average of approximately \$3.8 billion a day through their clearing systems for settlement from clearing firms whose positions had lost value to clearing firms whose positions had gained value. CME Clearing and CMECE reduce their guarantee exposure through initial and maintenance performance bond requirements and mandatory guaranty fund contributions. The company believes that its guarantee liability is immaterial and therefore has not recorded any liability at

March 31, 2016.

3. Property

In March 2016, the company sold its datacenter in the Chicago area for \$130.0 million. At the time of the sale, the company leased back a portion of the property. The sale leaseback transaction was recognized under the financing method and not as a sale leaseback arrangement under generally accepted accounting principles due to the company's participation in future revenues and development work, which constitutes continuing involvement in the datacenter. Under the financing method, the assets remain on the consolidated balance sheet throughout the term of the lease and the proceeds of \$130.0 million from the transaction are recognized as a finance lease obligation within other liabilities and other current liabilities in the consolidated

balance sheet. A portion of the lease payments will be recognized as a reduction of the finance lease obligation and a portion will be recognized as interest expense based on an imputed interest rate.

The net cost basis of the property and equipment legally sold was \$153.1 million at the date of the sale. At March 31, 2016, the company wrote down the property and equipment to a fair value of \$130.0 million based on qualitative indications of impairment and a quantitative analysis based on undiscounted cash flows. The company recognized a net loss on the transaction of \$27.1 million through other expenses, which includes the write down to fair value and certain other transaction-related costs. The company recognized a total net loss and expenses of \$28.6 million, which also includes \$1.5 million of legal and other fees incurred. The property and equipment legally sold will continue to be recognized on the consolidated balance sheets and will continue to be depreciated on the consolidated statements of income over the term of the lease.

The lease has an initial lease term ending in March 2031 and contains two consecutive renewal options for five years. Future minimum lease payments under this non-cancellable lease will be payable as follows as of March 31, 2016 (in millions):

Year	
Remainder of 2016	\$ 12.5
2017	16.7
2018	16.8
2019	16.8
2020	16.9
Thereafter	181.6
Total	\$261.3