



CME Group Inc. (CME)

Updated July 18th, 2019 by Samuel Smith

Key Metrics

Current Price:	\$206	5 Year CAGR Estimate:	-0.3%	Volatility Percentile:	16.0%
Fair Value Price:	\$138	5 Year Growth Estimate:	5.0%	Momentum Percentile:	82.6%
% Fair Value:	149%	5 Year Valuation Multiple Estimate:	-7.7%	Growth Percentile:	36.5%
Dividend Yield*:	2.4%	5 Year Price Target	\$176	Valuation Percentile:	9.3%
Dividend Risk Score:	B	Retirement Suitability Score:	D	Total Return Percentile:	4.6%

Overview & Current Events

CME Group is a Chicago-based company that operates futures and derivatives exchanges based on interest rates, equities, currencies, and commodities. The company was founded in 1898 but didn't IPO until 2002. Since then, CME Group has pursued industry consolidation through mergers (CBOT Holdings) and acquisitions (Nymex Holdings). It currently generates about \$4.4 billion in annual revenues and trades with a market cap of \$73 billion.

CME Group reported first quarter earnings on May 1st, announcing net income of \$497 million and \$1.39 of earnings per diluted share. Revenue came in at \$1.18 billion for the quarter. Results were boosted by strong volumes in interest rate products thanks to sustained uncertainty early in the year on the fate of short-term interest rates as well as the yield curve. Another factor driving the strong results were continued high demand volumes for equity derivatives.

Growth On A Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$2.48	\$2.86	\$5.43	\$2.70	\$2.92	\$3.35	\$3.69	\$4.53	\$11.94	\$5.71	\$6.76	\$8.63
DPS	\$0.92	\$0.92	\$1.12	\$1.79	\$1.80	\$1.88	\$2.00	\$2.40	\$2.64	\$2.80	\$3.00	\$4.39
Shares	333.0	332.0	334.0	332.0	334.0	336.0	338.0	339.0	340.0	344.0	162.8	162.8

Looking ahead we anticipate roughly 5% average annual earnings per share growth over the next half decade. This is a material slowdown from the over 8.5% annualized growth rate over the past decade, which we believe will result from the effect of the law of large numbers as well as its already significant industry consolidation, thereby limiting its growth runway. At the same time, we believe volatility in the public markets will remain strong for the foreseeable future as there remains enormous uncertainty on how various trade, geopolitical, global growth, and interest rate scenarios will play out to direct the near-term future of the American and global economies. Additionally, we expect CME to harvest significant synergies from its recent acquisition of Nymex Holdings, as their product offerings overlap nicely and enhance the overall competitive positioning of the firm. Finally, we see the company's extensive network and large volume to enable it to drive growth through starting ancillary services and exchange products, as well as sell order flow data to third parties. As a result, we expect CME Group to continue growing earnings-per-share at a steady mid-single digit clip for the foreseeable future.

** CME has a tradition of paying out a hefty special dividend at the end of most years. Last year it was \$1.75 per share, but at the end of 2017 it hit an all-time high of \$3.50. Looking ahead, we expect the average special dividend to be \$2.00 per share over the next five years, and have added this in to our dividend yield portion of the total return analysis, though we have left the dividend in the charts in this report to reflect the quarterly dividend only.*

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	16.49	23.67	11.90	18.33	17.57	23.27	24.18	19.60	9.73	25.59	30.5	20.4
Avg. Yld.	2.2%	1.4%	1.7%	3.6%	3.5%	2.4%	2.2%	2.7%	2.3%	1.9%	1.5%	2.5%

CME Group's average price to earnings multiple of 20.4 over the past decade is considerably lower than it is today, with the stock currently trading at 30.5 times expected 2019 earnings. We believe that, while the market is pricing in near

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term expectations of continued increases in volatility to drive strong growth in earnings, over the next several years, growth will slow considerably. As a result, the market will re-evaluate the earnings multiple applied to CME and ultimately drive it back towards historical averages. This will result in a significant 770 basis point annualized headwind to total returns for shareholders over the next half decade.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	37.1%	32.2%	20.6%	66.3%	61.6%	56.1%	54.2%	53.0%	22.1%	49.0%	44.4%	50.9%

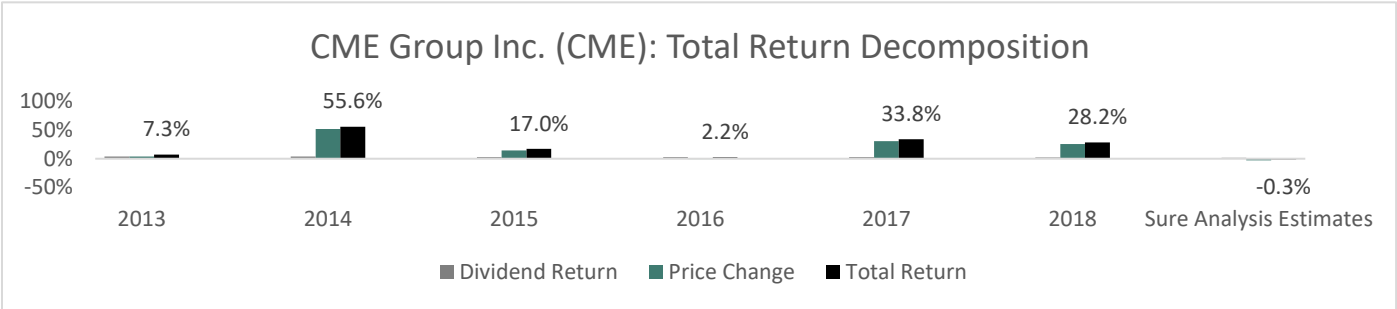
CME Group’s biggest competitive advantage is its network effect as a consolidator in the financial exchange space. Thanks to its large volume, it offers customers considerable liquidity, which is an extremely attractive feature for this industry. The company’s large volume also gives it economies of scale, enabling it to offer competitive pricing without considerably hurting profitability. This not only enables the company to retain customers, but also attracts new ones. As its customer count grows, its network effect only grows stronger, which in turn drives further liquidity and cost advantages, resulting in a virtuous cycle. Given that more than half of all interest rate-related futures in the world and nearly all North American interest rate-related futures are traded on the company’s exchange, it is clear that the company has established a dominant network effect in its core business.

While the company is not directly impacted by changes in stock market valuations, it did suffer during the last recession due to depressed market sentiment and customer bankruptcies dramatically reducing activity on the exchanges. From peak to trough, CME Group’s trailing twelve-month earnings per share fell from ~\$3.45 in mid-2008 to \$2.40 in mid-2009. The biggest long-term risk to the company is the potential for new regulation to disrupt the company’s business model, which could break up its exchange and clearing operations or even limit the volatility on the exchanges or its pricing power. However, we do not see any threat developing in the near future, making the business fairly low risk from a long-term perspective.

Final Thoughts & Recommendation

CME Group has grown considerably since its IPO 17 years ago thanks to industry consolidating mergers and acquisitions. Given its powerful network effect, we view it as a strong and stable company over the long term. We also believe that volatility will continue to increase in the near term, which will combine with continued acquisition synergy harvesting to sustain the exchange giant’s earnings-per-share growth at a mid-single digit (~5%) clip over the next half decade. That being said, the company’s dividend – while certainly safe and likely to continue growing given the current payout ratio – is unattractive at just a 2.4% yield (including an estimated \$2 per share special dividend each year). Furthermore, the valuation multiple is far above historical norms, leading us to project significant contraction in the coming years and a 770 basis point annual headwind to total returns. As a result, we expect that CME Group will lose investors money at a 0.3% rate per year over the next half decade, prompting us to rate it a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	2613	3004	3281	2915	2936	3113	3327	3595	3645	4309
Gross Profit	2084	2363	2584	2200	2198	2341	2558	2810	2862	3354
Gross Margin	79.7%	78.7%	78.8%	75.5%	74.9%	75.2%	76.9%	78.2%	78.5%	77.8%
SG&A Exp.	166	158	162	160	176	211	216	136	146	171
D&A Exp.	251	258	261	253	238	233	229	225	209	249
Operating Profit	1594	1831	2021	1692	1637	1768	1989	2201	2311	2608
Operating Margin	61.0%	61.0%	61.6%	58.1%	55.8%	56.8%	59.8%	61.2%	63.4%	60.5%
Net Profit	826	951	1812	896	977	1127	1247	1534	4063	1962
Net Margin	31.6%	31.7%	55.2%	30.8%	33.3%	36.2%	37.5%	42.7%	112%	45.5%
Free Cash Flow	925	1200	1174	1078	1155	1151	1418	1640	1669	2324
Income Tax	612	770	122	787	623	645	710	754	-1537	814

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	35651	35046	40759	38863	54278	72242	67359	69369	75791	77476
Cash & Equivalents	261	855	1042	1605	2470	1366	1693	1869	1904	1375
Accounts Receivable	248	298	289	268	303	341	358	364	360	553
Goodwill & Int. Ass.	27778	28477	28337	27596	27486	27382	27282	27186	27091	33481
Total Liabilities	16350	14918	19207	17438	33117	51318	46808	49029	53379	51510
Accounts Payable	47	52	31	42	36	37	29	26	31	116
Long-Term Debt	2315	2525	2107	2857	2857	2108	2229	2231	2233	4401
Shareholder's Equity	19301	20060	21552	21419	21155	20924	20552	20341	22412	25919
D/E Ratio	0.12	0.13	0.10	0.13	0.14	0.10	0.11	0.11	0.10	0.17

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.0%	2.7%	4.8%	2.3%	2.1%	1.8%	1.8%	2.2%	5.6%	2.6%
Return on Equity	4.3%	4.8%	8.7%	4.2%	4.6%	5.4%	6.0%	7.5%	19.0%	8.1%
ROIC	3.8%	4.3%	7.8%	3.7%	4.0%	4.8%	5.4%	6.8%	17.2%	7.1%
Shares Out.	333.0	332.0	334.0	332.0	334.0	336.0	338.0	339.0	340.0	344.0
Revenue/Share	7.85	9.03	9.83	8.77	8.78	9.26	9.85	10.61	10.71	12.54
FCF/Share	2.78	3.61	3.52	3.24	3.45	3.42	4.20	4.84	4.91	6.76

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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