CME Group Inc. (CME)

Updated August 13th, 2021 by Samuel Smith

Key Metrics

Current Price:	$209.8	**5 Year CAGR Estimate:**	-1.7%	**Market Cap:**	$75.4B
Fair Value Price:	$134.6	**5 Year Growth Estimate:**	5.1%	**Ex-Dividend Date:**	9/9/21
% Fair Value:	156%	**5 Year Valuation Multiple Estimate:**	-8.5%	**Dividend Payment Date:**	9/27/21
Dividend Yield:	1.7%	**5 Year Price Target**	$173	**Years Of Dividend Growth:**	17
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	9.4%

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 $4.8 billion in annual revenues and trades with a market capitalization of $75.4 billion.

CME Group reported second quarter earnings on July 28th, 2021. Adjusted earnings-per-share for the quarter came in at $1.64, up slightly from $1.63 a year ago. The $1.18 billion in total revenue generated this quarter exceeded the average analyst estimate and declined from $1.25 billion in Q1. Q2 revenue received from clearing and transaction fees was also down to $930 million from last year's second quarter, which puts the average rate per contract at $0.695. Also, the average daily volume of CME Group was 18.44 million, down from 21.8 million sequentially and up from 17.60 million year-over-year. The company's market data revenue increased to $145 million. Lastly, total expenses reported fell to $505 million from $545 million year-over-year.

Growth On A Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$5.43	$2.70	$2.92	$3.35	$3.69	$4.53	$11.94	$5.71	$6.85	$6.72	***$6.73***	***$8.63***
DPS	$1.12	$1.79	$1.80	$1.88	$2.00	$2.40	$2.64	$2.80	$3.00	$3.40	***$3.60***	***$4.39***
Shares[1]	334	332	334	336	338	339	340	341	358	358	***358***	***358***

Looking ahead we anticipate 5.1% average annual earnings per share growth over the next half decade. This is a material increase from the annualized growth rate over the past decade, which we believe will result from volatility in the public markets 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 enabling 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 clip for the foreseeable future.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	23.7	11.9	18.3	17.6	23.3	24.2	19.6	9.7	25.6	24.7	***31.2***	***20.0***
Avg. Yld.	0.9%	5.6%	3.4%	3.2%	2.3%	2.2%	1.1%	5.1%	1.7%	2.0%	***1.7%***	***2.5%***

CME Group's average price to earnings multiple of 20.4 over the past decade is considerably below where it is today, with the stock currently trading at 31.2 times expected 2021 earnings. We believe that, while the market is experiencing near term expectations of continued increases in volatility to drive strong growth in earnings, over the next several years

[1] In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

growth will slow considerably. As a result, we are maintaining our fair value estimate of 20x earnings and believe the stock is significantly overvalued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	20.6%	66.3%	61.6%	56.1%	54.2%	53.0%	22.1%	49.0%	45.0%	50.6%	***53.5%***	***50.9%***

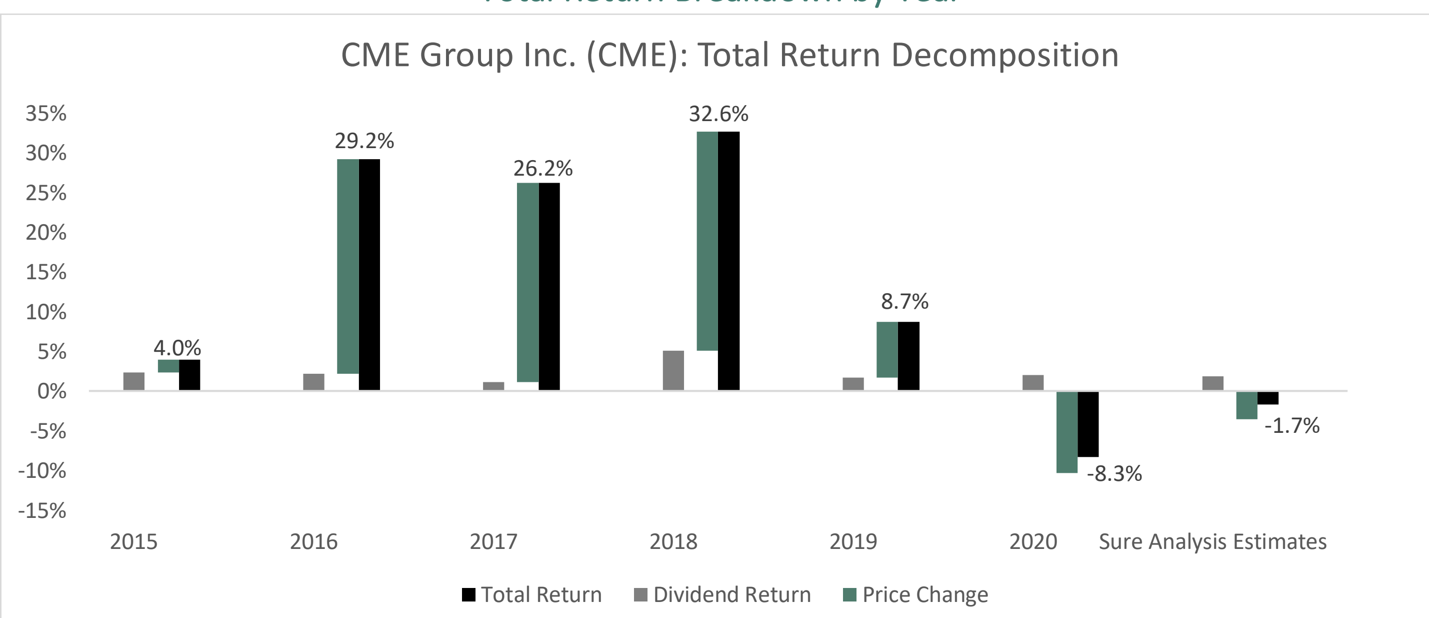
CME Group's biggest competitive advantage is its network effect as a consolidator in the financial exchange space. Thanks to its large volume, it offers customers considerable liquidity, which is an extremely attractive feature for this industry. The company's large volume also gives it economies of 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 exchanges, 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 benefits from increased volatility. Given the increasing geo-political and macroeconomic uncertainties in the world today, this could bode well for the business. At the same time, the valuation currently stands at a very rich level. As a result, with mere -1.7% expected annualized returns over the next half decade, we label shares as a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	3,281	2,915	2,936	3,113	3,327	3,595	3,645	4,309	4,868	4,884
Gross Profit	2,763	2,378	2,382	2,528	2,745	3,052	3,081	3,637	3,969	4,027
Gross Margin	84.2%	81.6%	81.1%	81.2%	82.5%	84.9%	84.5%	84.4%	81.5%	82.5%
SG&A Exp.	341	337	360	398	404	378	366	454	548	635
D&A Exp.	261	253	238	233	229	225	209	249	473	
Operating Profit	2,021	1,692	1,637	1,768	1,989	2,201	2,311	2,608	2,588	2,637
Operating Margin	61.6%	58.1%	55.8%	56.8%	59.8%	61.2%	63.4%	60.5%	53.2%	54.0%
Net Profit	1,812	896	977	1,127	1,247	1,534	4,063	1,962	2,117	2,105
Net Margin	55.2%	30.8%	33.3%	36.2%	37.5%	42.7%	112%	45.5%	43.5%	43.1%
Free Cash Flow	1,174	1,078	1,155	1,151	1,418	1,640	1,669	2,324	2,427	
Income Tax	122	787	623	645	710	754	-1537	814	574	616

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	40759	38863	54278	72242	67359	69369	75791	77476	75215	124660
Cash & Equivalents	1042	1605	2470	1366	1693	1869	1904	1375	1551	1633
Accounts Receivable	289	268	303	341	358	364	360	553	492	461
Goodwill & Int. Ass.	28337	27596	27486	27382	27282	27186	27091	33481	33036	32839
Total Liabilities	19207	17438	33117	51318	46808	49029	53379	51510	49056	98308
Accounts Payable	31	42	36	37	29	26	31	116	62	69
Long-Term Debt	2107	2857	2857	2108	2229	2231	2233	4401	3743	3444
Shareholder's Equity	21552	21419	21155	20924	20552	20341	22412	25919	26129	26320
D/E Ratio	0.10	0.13	0.14	0.10	0.11	0.11	0.10	0.17	0.14	0.13

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	4.8%	2.3%	2.1%	1.8%	1.8%	2.2%	5.6%	2.6%	2.8%	2.1%
Return on Equity	8.7%	4.2%	4.6%	5.4%	6.0%	7.5%	19.0%	8.1%	8.1%	8.0%
ROIC	7.8%	3.7%	4.0%	4.8%	5.4%	6.8%	17.2%	7.1%	7.0%	7.1%
Shares Out.	334	332	334	336	338	339	340	341	358	358
Revenue/Share	9.83	8.77	8.78	9.26	9.85	10.61	10.71	12.54	13.59	13.62
FCF/Share	3.52	3.24	3.45	3.42	4.20	4.84	4.91	6.76	6.78	

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