CME Group Inc. (CME)

Updated August 2nd, 2022 by Samuel Smith

Key Metrics

Current Price:	$195.8	**5 Year CAGR Estimate:**	-0.2%	**Market Cap:**	$71.7 B
Fair Value Price:	$159.2	**5 Year Growth Estimate:**	1.6%	**Ex-Dividend Date:**	09/9/22[1]
% Fair Value:	123%	**5 Year Valuation Multiple Estimate:**	-4.1%	**Dividend Payment Date:**	09/27/22[2]
Dividend Yield:	2.0%	**5 Year Price Target**	$173	**Years Of Dividend Growth:**	17
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Rating:**	Sell

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 $5 billion in annual revenues and trades with a market capitalization of $71.7 billion.

CME Group reported second quarter earnings on July 27th, 2022. Revenue increased 1.7% to $1.2 billion year-over-year. Operating income stood at $750 million, up from $675 million in the year-ago period. Adjusted net income stood at $717 million while non-GAAP earnings-per-share stood at $1.97. Q2 average daily volume stood at 23.1 million contracts which includes non-U.S. average daily volume of 6.3 million contracts. Meanwhile, Q2 revenue received from clearing and transaction fees increased to $1.0 billion from $923 million in the year-ago period, which puts the average rate per contract at $0.647. Market data revenue totaled $152 million. The CME Group also reported approximately $2.0 billion in cash and $3.4 billion of debt as of June 30, 2022.

Growth On A Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$2.70	$2.92	$3.35	$3.69	$4.53	$11.94	$5.71	$6.85	$6.72	$6.67	***$7.96***	***$8.63***
DPS	$1.79	$1.80	$1.88	$2.00	$2.40	$2.64	$2.80	$3.00	$3.40	$3.60	***$4.00***	***$4.39***
Shares[3]	333.6	335.7	337.3	338.4	339.7	340.4	357.8	358.4	359.0	358.6	***358.6***	***360.0***

Looking ahead we anticipate 1.6% average annual earnings per share growth over the next half decade. The main tailwind for the company is 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 slow but steady clip for the foreseeable future.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	11.9	18.3	17.6	23.3	24.2	19.6	9.7	25.6	24.7	32.8	***24.6***	***20.0***
Avg. Yld.	5.6%	3.4%	3.2%	2.3%	2.2%	1.1%	5.1%	1.7%	2.0%	1.7%	***2.0%***	***2.5%***

[1] Estimate
[2] Estimate
[3] 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.

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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 24.6 times expected 2022 earnings. We believe that, while the market is experiencing near term expectations of continued increases in volatility to drive growth in earnings, over the next several years 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	66.3%	61.6%	56.1%	54.2%	53.0%	22.1%	49.0%	45.0%	50.6%	54.1%	***50.3%***	***50.9%***

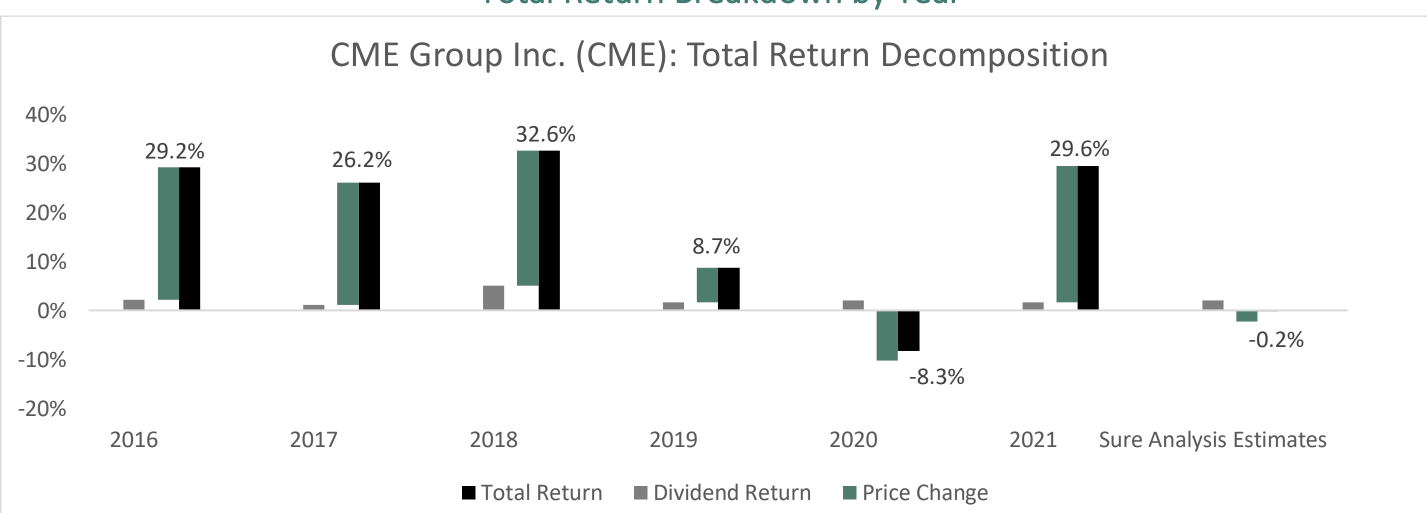
CME Group's biggest competitive advantage is its network effect as a consolidator in the financial exchange space. Thanks to its large volume, it offers customers considerable liquidity, which is an extremely attractive feature for this industry. The company's large volume also gives it economies of 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 a -0.2% expected annualized return over the next half decade, we label shares as a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	2,915	2,936	3,113	3,327	3,595	3,645	4,309	4,868	4,884	4,690
Gross Profit	2,378	2,382	2,528	2,745	3,052	3,081	3,637	3,969	4,027	3,853
Gross Margin	81.6%	81.1%	81.2%	82.5%	84.9%	84.5%	84.4%	81.5%	82.5%	82.2%
SG&A Exp.	337	360	398	404	378	366	454	548	635	581
D&A Exp.	253	238	233	229	225	209	249	473	464	385
Operating Profit	1,692	1,637	1,768	1,989	2,201	2,311	2,608	2,588	2,637	2,645
Operating Margin	58.1%	55.8%	56.8%	59.8%	61.2%	63.4%	60.5%	53.2%	54.0%	56.4%
Net Profit	896	977	1,127	1,247	1,534	4,063	1,962	2,117	2,105	2,636
Net Margin	30.8%	33.3%	36.2%	37.5%	42.7%	111.5%	45.5%	43.5%	43.1%	56.2%
Free Cash Flow	1,078	1,155	1,151	1,418	1,640	1,669	2,324	2,427	2,518	2,275
Income Tax	787	623	645	710	754	(1,537)	814	574	616	737

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	38,863	54,278	72,242	67,359	69,369	75,791	77,476	75,215	124,660	196,780
Cash & Equivalents	1,605	2,470	1,366	1,693	1,869	1,904	1,375	1,551	1,633	2,835
Accounts Receivable	268	303	341	358	364	360	553	492	461	435
Goodwill & Int. Ass.	27,596	27,486	27,382	27,282	27,186	27,091	33,481	33,036	32,839	31,235
Total Liabilities	17,438	33,117	51,318	46,808	49,029	53,379	51,510	49,056	98,308	169,381
Accounts Payable	42	36	37	29	26	31	116	62	69	49
Long-Term Debt	2,857	2,857	2,108	2,229	2,231	2,233	4,401	3,743	3,444	3,445
Shareholder's Equity	21,419	21,155	20,924	20,552	20,341	22,412	25,919	26,129	26,320	27,399
LTD/E Ratio	0.13	0.14	0.10	0.11	0.11	0.10	0.17	0.14	0.13	0.13

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.3%	2.1%	1.8%	1.8%	2.2%	5.6%	2.6%	2.8%	2.1%	1.6%
Return on Equity	4.2%	4.6%	5.4%	6.0%	7.5%	19.0%	8.1%	8.1%	8.0%	9.8%
ROIC	3.7%	4.0%	4.8%	5.4%	6.8%	17.2%	7.1%	7.0%	7.1%	8.7%
Shares Out.	333.6	335.7	337.3	338.4	339.7	340.4	357.8	358.4	359.0	358.6
Revenue/Share	8.77	8.78	9.26	9.85	10.61	10.71	12.54	13.59	13.62	13.07
FCF/Share	3.24	3.45	3.42	4.20	4.84	4.91	6.76	6.78	7.02	6.34

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