



ANALYST QUICK NOTES

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CME Group Inc. (NGS: CME: BUY)

Target Price: \$134

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Investment Thesis

- February volumes (announced Mar. 2) averaged 18.4 million contracts, down 1% from 18.7 million in Feb. 2016:
 - Monthly volumes in 2016 generally in 14-16 million range.
 - 1Q volume so far averaging 17.2 million for Jan./Feb., ahead of all quarters last year except 1Q.
- Volume trends likely running ahead of most Street estimates:
 - Potential for 1Q EPS beat and higher 2017 consensus.
 - Argus is at \$1.25 for 1Q, versus consensus of \$1.17.
 - CME has exceeded consensus by \$0.01 to \$0.05 the past four quarters.
- Expect trading volumes to remain elevated:
 - Running well above second-half 2016 average despite a complacent, one-directional market over the past few months.
 - Repositioning around sooner-than-expected rate hikes.
 - Political uncertainties leading to speculation and hedging.
 - Some volume has moved from underlying equity trades to derivative options and futures trading.
- Mix shift expected to have favorable impact, with volume growth strong for higher-priced contracts:
 - Agricultural contracts average \$1.34/contract, volumes up 12% year-over-year in February.
 - Metals contracts average \$1.46/contract, up 7% in February.
 - Interest rate contracts average \$0.49/contract, up 9% in February.
 - Lower-priced equities, energy and FX volumes down in February.

- Open interest has remained elevated:
 - 120.3 million contracts at March 5, up from 105.0 million in mid-2016 and 91.3 million at 2015 year end.
 - High open interest is generally a good indication of volume trends continuing.
 - In early February, CME increased the quarterly dividend by 10% to \$0.66, for a 2.1% yield.
 - With an effective tax rate average of 34.6% the past two years, CME would be a strong beneficiary of lower corporate tax rates.
 - The operating margin expansion story continues as 8% revenue growth is leveraged by low single-digit growth in operating expenses.
 - We see operating margins improving to 64% in 2017 and 65% in 2018, from 61% in 2016.
 - Our target price of \$134 implies 28-times our 2017 EPS estimate of \$4.82:
 - The high end of the five-year P/E range is justified by record operating margins.
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