

Cboe Global Markets, Inc.
Fourth Quarter 2020 Earnings Call - Prepared Remarks
February 5, 2021

Debbie Koopman

Good morning and thank you for joining us for our fourth quarter earnings conference call. On the call today, Ed Tilly, our Chairman, President and CEO, will discuss our performance for the quarter and the year and provide an update on our strategic initiatives. Then, Brian Schell, our Executive Vice President, CFO and Treasurer, will provide an overview of our financial results for the quarter and the full year as well as discuss our 2021 financial outlook. Following their comments, we will open the call to Q&A. Also joining us for Q&A will be our Chief Operating Officer, Chris Isaacson and our Chief Strategy Officer, John Deters.

In addition, I would like to point out that this presentation will include the use of slides. We will be showing the slides and providing commentary on each. A downloadable copy of the slide presentation is available on the investor relations portion of our website.

During our remarks, we will make some forward-looking statements, which represent our current judgment on what the future may hold, and while we believe these judgments are reasonable, these forward-looking statements are not guarantees of future performance and involve certain assumptions, risks and uncertainties. Actual outcomes and results may differ materially from what is expressed or implied in any forward-looking statements. Please refer to our filings with the SEC for a full discussion of the factors that may affect 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, after this conference call.

During the course of the call this morning, we will be referring to non-GAAP measures as defined and reconciled in our earnings materials. Now, I'd like to turn the call over to Ed.

Ed Tilly, Chairman, President & CEO

Good morning and thank you for joining us today. I hope 2021 is off to a great start for everyone and you are keeping safe and well as we continue to navigate this pandemic.

I'm pleased to report that Cboe posted solid fourth quarter and record full-year results highlighting the strength and diversification of our global business. For the year, we grew net revenue by 10% and adjusted EPS by 11% despite an unprecedented macroenvironment that, for much of the year, did not favor index trading.

Our results were driven by record trading volumes in U.S. cash equities and multi-list options, fueled by strong retail trading, growth in recurring non-transactional revenues and increased efficiency enabled by our fully integrated, superior technology.

Importantly, while achieving strong growth we continued to successfully execute key growth initiatives to advance our strategy to leverage product innovation and superior technology, expand our customer base and diversify our business mix with recurring revenue.

We also maintained our commitment to operational excellence in 2020, as evidenced by the continuity and resiliency of our markets despite the year's unrelenting challenges. Our ability to provide reliable and continuous markets in that environment, while continuing to execute key strategic initiatives and post strong growth, is a testament to the dedication and expertise of our entire global team.

Additionally, our record results and strong cash flow generation enabled us to return \$520 million to shareholders in 2020, a new all-time high and a 69% increase compared to 2019. Our commitment to returning capital to shareholders will continue in 2021 and beyond, reinforced by today's announcement regarding the Board's authorization of additional share buyback capacity.

Turning to our targets and expectations for this year, we plan to leverage the deals we closed in 2020 to accelerate organic growth in 2021.

Brian will do a deeper dive on this, but we plan to invest approximately \$25 million in organic growth initiatives in 2021, which we expect to contribute to our incremental, top-line compounded average organic growth target of 4 to 6 percent over the mid-term. As you've seen since our IPO, we have also allocated capital inorganically to help accelerate our strategy while returning capital to shareholders.

Over the past four years, we have delivered 5 percent compound annual net revenue growth while growing adjusted EPS by 19%, on a proforma basis, which reflects the strength of our strategy and our ability to perform in the most challenging cycles. The success of our ongoing diversification reinforces our confidence in continued growth.

Additionally, while we're only five weeks into the new year, we are beginning to see institutional investors re-engage in trading our index options and volatility products. In January, month-over-month volume increased by 77 percent in VIX futures, 68 percent in VIX options and 15 percent in SPX options.

As we've noted in previous calls, we expected to see re-engagement in these products once there was more clarity around the political and pandemic uncertainty that clouded investors' views on where the market was headed. Although much uncertainty remains around the Covid-19 pandemic, the vaccine rollout has begun, the new U.S. administration is in place, and the Brexit deal has been executed. We believe we will continue to see increased trading in our index products as the uncertainty of these, and other previous market unknowns, come into focus.

Additionally, in response to customer demand, similar to VIX Futures, we are planning to extend the 24x5 trading model to VIX and SPX options in the fourth quarter of this year, subject to regulatory review. Over 15 percent of trading in VIX Futures, which already trade 24x5, took place in non-U.S. trading hours last year, up from 13 percent in 2019. Naturally, we believe 24x5 trading in VIX and SPX options will result in increased trading outside of U.S. hours as well.

We began the year with a considerable amount of momentum from strategic progress made in 2020. We are excited about both the near and long-term opportunities to grow and expand our business driven in part by increases in proprietary product trading, recurring revenue, and retail engagement, while continuing to invest in long-term growth.

Our ongoing strategy, which has reinforced the value of our unique platform and fueled our strong year-over-year growth, remains consistent: further strengthen our core proprietary products, leverage

our superior technology, increase recurring revenue, broaden our geographic footprint, and expand our product line by asset class. We have exciting initiatives underway within each of these strategic pillars, but today I'd like to focus on four key incremental growth drivers – the opportunity to grow non-transactional revenue through Cboe Information Solutions, and our plans to launch Cboe Europe Derivatives, expand BIDS Trading and grow our retail trading base.

We're excited about our prospects to further increase recurring revenue through expanding and enhancing Cboe Information Solutions, our comprehensive suite of data solutions, analytics and indices. These products generate recurring revenue by providing market participants with value-added trading resources and support transaction growth in our proprietary products with tools that draw users to our markets and drive volume as they re-establish trading positions.

As discussed in previous calls, last year's expansion of our Information Solutions offering through key acquisitions accelerated our ability to grow our recurring non-transactional revenue. In 2020, we reported 12% growth in recurring non-transactional revenue and 9% organic growth, and we expect to see incremental sustainable long-term growth as we continue to optimize these integrations in 2021.

Importantly, our expansion of Information Solutions now allows us to interact with and add value to market participants at every step of the trade process. We are looking to enhance these customer support opportunities in 2021 with additional portfolio and margin risk analytics offered through various delivery mechanisms, including through Cboe Silexx, our proprietary order execution management system, and through our APIs. Additionally, we plan to expand our market intelligence analytics and alerts to many market segments, including retail traders. We also plan to expand our global indices platform, which provides index calculation development and services with real-time distribution channels. Finally, we expect to further expand our offering of unique historical data sets and add high-demand data sets like cryptocurrencies to the Information Solutions data suite.

Turning now to the upcoming planned launch of Cboe Europe Derivatives. I'm pleased to say we are on track to launch in the second quarter of this year, pending regulatory approval, bringing to fruition our vision to unlock the potential we see for considerable growth in this market.

Our highly successful European equities business, global derivatives expertise and ownership of EuroCCP uniquely position us to simplify and bring new efficiencies to pan-European derivatives trading and clearing. We've worked closely with market participants in shaping our plans and have received very positive customer feedback and support.

During the fourth quarter we made strong progress on the technical build-out of the exchange and clearing platform and toward achieving the necessary regulatory approvals. Customer testing and optimization is ongoing, and we have commitments from clearing firms, order flow providers and market makers to be there on day one.

As we've said before, we think this market is ripe for significant structural growth. We are not aiming simply to take market share from incumbent exchanges; we intend to reshape and grow overall derivatives trading in Europe with a novel market structure designed to attract both new and existing participants.

While our revenue expectations for European derivatives in 2021 are modest, we are investing for long-term growth and looking for a gradual revenue build as we gain traction and expand our product offering to realize what we view as a paradigm shift in European derivatives trading.

Our new Amsterdam exchange, which we launched in 2019 in advance of Brexit, will serve as home to our derivatives business in the region. I'll also note here that the flawless implementation of our Brexit strategy enabled us to seamlessly transition trading from our UK venue to Amsterdam at the start of the year. Also, as a result of Brexit, we were excited to welcome back trading of Swiss shares on our UK venue yesterday. We are working with customers to re-establish our market share in Swiss equities trading, which was approximately 8% of Cboe Europe's notional value traded in June 2019 when Swiss trading was last available on our market.

Turning now to our acquisition of BIDS Trading, which we completed at the end of the fourth quarter. We are pleased to welcome Tim Mahoney and team to the Cboe family.

We have a successful track record of working with BIDS, which powers Cboe LIS, one of the largest block-trading platforms in Europe. While BIDS will continue to operate as an independently managed venue, the acquisition helps enable us to expand BIDS' block trading capabilities and services to other products and geographies, including Canada, as we look to further expand our presence in North American equities.

We are well underway with our integration of MatchNOW, the Canadian ATS we acquired last year, and the BIDS acquisition provides additional features that we believe will help us disrupt the electronic block market in Canada and other markets in the future.

BIDS has an extensive global network of more than 460 buy-side investment managers and sell-side constituents, which differentiates the platform and provides a strong foundation from which to expand into new markets. BIDS also provides us with a foothold in the off-exchange segment of the U.S. equities market, which now accounts for over 45 percent of overall U.S. equities trading volume.

Moving on to retail trading, we believe the resurgence of the retail investor we saw in 2020 is here to stay. We are well-equipped to deliver tailored products and services to meet the needs of this growing customer base and to evolve our education programs with retail-centric content to empower these new investors.

Product innovation remains a core focus of the Cboe franchise, and we plan to continue to expand our proprietary product offering with smaller contract sizes that appeal to both sophisticated retail traders and institutional investors. This includes Mini VIX futures and Mini SPX options, our recently announced Mini Russell 2000 index options, as well as additional retail-focused products in our pipeline, which will extend our value add to a broader universe of investors. Our strategy to nurture growth in these products, which is driven by a cross-functional team focused on dedicated client services, targeted marketing initiatives and robust investor education, is well underway.

Additionally, we continued to see increased retail trading in U.S. equities and record volume in our Retail Priority program, which helps improve execution quality and trading outcomes for individual investors and firms that facilitate their orders. Volume in Retail Priority orders represented over 31 percent of total volume on Cboe EDGX with the exchange reaching record market share of 7.3 percent in the fourth quarter. In January, trading on EDGX set a new monthly ADV record, as did retail priority orders which were up 56 percent over December 2020.

We're excited to see growing retail engagement in the marketplace, and we are well-positioned to invest in and leverage our core strengths – product and market innovation, technology, strong customer relationships, and investor education – to support this growing user base. We believe our

investments in this area will benefit retail investors and create another, sustainable, long-term growth opportunity for Cboe.

With that, I'll turn it over to Brian to walk through our 2020 performance and 2021 outlook in greater detail and then I'll provide some closing remarks.

With that, I thank you for your attention and will turn it over to Brian.

Brian Schell, CFO

Thanks Ed, and good morning everyone. I hope all of you and your families are remaining safe and healthy.

Let me remind everyone that unless specifically noted, my comments relate to 4Q20 as compared to 4Q19 and are based on our non-GAAP adjusted results.

We reported solid financial results for the quarter, again, highlighting the diversification of our revenue streams and the contributions from our investments and acquisitions, reinforcing our strategic initiatives:

- Our net revenue increased 10%, with net transaction fees up 8% and revenue from our recurring non-transactional revenue up 16%;
- Adjusted operating expenses increased 17%;
- Adjusted EBITDA of \$206 million was up 4%;
- And finally, our adjusted diluted earnings per share was \$1.21, flat to last year.

Turning to the key drivers by segment. Our press release and the appendix of our slide deck includes information detailing the key metrics for each of our business segments, so I'll just provide summary thoughts:

- The growth in our options segment was driven by a continuation of strong trading in our multi-listed options and higher revenue from proprietary market data, offset somewhat by lower volumes in our proprietary products.
- Revenue from North American equities decreased as a result of lower market data revenue from the SIP, including lower SIP audit recoveries. Off-exchange or TRF volume hit new highs again in the fourth quarter, impacting our market share.
- In Futures, the revenue decline was caused by lower trading volume in VIX futures.
- The revenue increase in European Equities primarily reflects the addition of EuroCCP.
- In FX, increased ADNV drove higher transaction fees and growth in access and capacity fees contributed to higher non-transactional revenue. We're also proud to announce our market share surged to a new record high of 16.7%.

Turning to expenses, total adjusted operating expenses were about \$112 million for the quarter, up 17% against last year's fourth quarter. Excluding the impact of acquisitions, adjusted operating expenses were up 4% for the quarter and actually down 2% for the year. The majority of the expense variance related to the acquisitions was compensation and benefits.

Turning now to our 2021 guidance.

As Ed noted, our plans for 2021 and beyond call for continued investments to drive long-term sustainable growth in our business. For 2021, our organic revenue target is a growth rate of 6 to 7% from our recurring non-transactional revenue, which we define as access and capacity fees plus proprietary market data fees. Similar to prior years, we anticipate the majority of this growth to be driven by additional units versus pricing changes. After incorporating our ISG acquisitions, we expect the reported or total growth rate for this category to be 7 to 8%. In the aggregate, we expect the acquisitions closed in 2020 to contribute additional growth of 4 to 6% in 2021.

Longer- to mid-term, we are targeting organic top-line compounded average growth of 4 to 6 percent. Given our growth plans and strategic opportunities, we are planning incremental investment of \$24 to \$26 million in 2021 to help increase that growth rate in the future, which I'll discuss further in a moment.

Expense Guidance:

Moving to our expense guidance, we expect adjusted operating expenses to be in a range of \$531 to \$539 million versus \$416 million in 2020. The projected \$115 - \$123 million YoY expense increase falls into three main categories – 2020 normalization, core and incremental investment.

- First, 2020 Normalization. Approximately \$71 million, or nearly 60% of the increase, is due to incremental expenses from 2020 acquisitions (\$55 million), which will contribute to our long-term growth profile, as well as non-recurring savings in 2020 that we do not expect to repeat in 2021. The non-recurring savings realized in 2020 include (1) COVID-related savings, (2) favorable accrual adjustments related to incentive compensation and facilities expenses and (3) delays in hiring, which were also caused by disruptions related to COVID-19. If you normalize our 2020 expenses for these items, the projected expense increase is approximately 10%. Based on the current market outlook, we expect these costs will recur in 2022 and beyond, although as we demonstrated in 2020, we are able to optimize our costs to preserve our differentiated track record of margin expansion.
- Second, core expenses. We expect these expenses to increase by approximately \$14 to \$18 million, or 3 to 4% growth. This category includes our annual compensation adjustments, incremental infrastructure costs and otherwise general price increases. However, should we remain in a more “locked-down” state for an extended period of time in 2021, the expected expense growth should be muted. We expect to also incur incremental facility “overlap” costs of approximately \$7 to \$8 million as we transition our Chicago headquarters and other office space. We do not expect the majority of this cost to recur in 2022.
- And finally – incremental investment. As Ed highlighted earlier, in support of our strategy, we plan to invest approximately \$24 to \$26 million in 2021 to drive incremental and sustainable long-term organic revenue growth in high-conviction, high-return opportunities. This includes \$9 to \$10 million for our previously announced European Derivatives buildout, as well as investments aimed at supporting growth in index options and futures, including developing, listing and distributing unique products and enhancing marketing, education and content as well as our efforts to tap into the growing base of retail investors, among other initiatives.

As we have demonstrated in the past, we have the flexibility to adjust the magnitude of our overall spend through the year. Should market conditions for our transaction revenue weaken, there are multiple levers with which we may adjust our investment levels to help realize the strong underlying margin profile in our business model. As the year develops, we will revisit how we are calibrating our investments to the current market reality to optimize both margins and long-term growth potential. .

Turning now to our summary of full-year guidance on the next slide, we expect depreciation and amortization to be \$38 to \$42 million for 2021, compared to \$34 million in 2020. This excludes amortization of intangibles of approximately \$116 million.

Moving to income taxes, our effective tax rate on adjusted earnings for the quarter was 28.6%, above last year's fourth quarter rate of 24.7%. Absent the higher tax rate, earnings per share would have increased 6%, which reflects the impact of higher adjusted earnings netted against the incremental benefit of reducing our share count by nearly 3% over the last 12 months. Our full-year 2021 tax rate on adjusted earnings is expected to be in a range of 27.5% to 29.5%, versus 28.1% in 2020.

Finally, we expect 2021 capital spending to be a range of \$60 to \$65 million, reflecting expenditures for the build out of a new trading floor and higher investments in technology and infrastructure to support our acquisitions and other growth initiatives. We expect 2021 to be an above trend-line capex year due to the various investments noted, and over time, we expect capex to return to a more normalized level of \$40 to \$45 million.

While we are not providing full year guidance on interest expense, we wanted to highlight that absent any additional borrowing and significant changes to LIBOR, our quarterly interest expense for the first quarter of 2021 is expected to be \$12 - \$13 million, which is slightly lower than 4Q 2020, which included incremental fees related to refinancing costs.

Moving to capital allocation, our priorities have not changed as we remain committed to investing in our growth strategy while returning excess cash to shareholders through dividends and share repurchases. As you heard from Ed, recent acquisitions of EuroCCP and BIDS reflect conviction in our ability to deploy capital to help enhance organic growth and strategic value over time, leveraging the robust technology at the core of our strong operating leverage profile. From a capital return perspective, our record financial results in 2020 and cash flow generation enabled us to return the highest amount of cash to shareholders since becoming a public company. We plan to continue being opportunistic with share repurchases as highlighted by this morning's announcement of up to an additional \$200 million in buyback capacity, bringing our total availability to approximately \$400 million as of the end of January 2021.

In December, we completed a \$500 million bond offering used to fund the BIDS acquisition, repay amounts outstanding under our revolving line of credit and a portion of amounts outstanding under our term loan, as well as other general corporate purposes. Our leverage ratio increased to 1.4 times at December 31 from 1.1 times at September 30, due to the higher debt outstanding. We ended the year with adjusted cash of \$210 million, reflecting in part, higher balances associated with additional regulatory and operating cash needs for EuroCCP.

Now I'd like to turn it back over to Ed for some closing comments before we open it up to Q&A.

Ed Tilly

Thanks, Brian. In closing, we are extremely proud of the results we delivered last year and are optimistic about opportunities to leverage our recent acquisitions to grow our business. Our operating results highlight the strength of our diversified business and our team's consistent execution of our strategy. By further strengthening our core proprietary products, leveraging our superior technology, increasing recurring revenue, broadening our geographic footprint, and expanding our product line by asset class, we will be well positioned to achieve our mission to build one of the world's largest global securities and derivatives trading networks.

The investments we plan to make this year are expected to contribute to our long-term growth in 2022 and beyond. We also plan to continue to exercise disciplined expense management and efficient allocation of capital to create long-term shareholder value, and believe we have the people, technology, and expertise to continue to define markets in a very powerful way.

With that, I'll turn to Debbie for instructions on the Q&A portion of the call.

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