Cboe Global Markets, Inc.
First Quarter 2021 Earnings Call - Prepared Remarks
April 30, 2021

Debbie Koopman, VP Investor Relations

Good morning and thank you for joining us for our first quarter earnings conference call. On the call today, Ed Tilly, our Chairman, President and CEO, will discuss our performance for the quarter 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 as well as update 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, Vice Chairman, President and CEO

Good morning and thank you for joining us today. I hope you are all doing well and staying healthy.

We reported solid financial results for the first quarter of 2021 at Cboe Global Markets while continuing to successfully execute on our strategic growth plan to expand our geographic and asset class footprint, broaden our customer reach, diversify our business mix with recurring revenue and leverage our superior technology.

As expected, we have more difficult comparisons this quarter against last year's record first-quarter earnings when we saw exceptionally strong trading as the Covid-19 pandemic began sweeping the globe. For the quarter, net revenue was up 2%, and adjusted EPS was down 7% year-over-year. However, we saw very strong sequential growth across business segments with net revenue up 19% over the fourth quarter of 2020 and adjusted EPS up 26%.

Our solid results were driven by record trading in multi-listed options and continued growth in our recurring non-transaction revenues, as well as the contribution from the acquisitions we completed in 2020.

I want to update you on the progress we've made this year on four key incremental growth drivers I highlighted last quarter – our plans to launch Cboe Europe Derivatives, the opportunity to grow recurring non-transaction revenue, our plans to expand BIDS Trading, and efforts to extend access to our products and services, including retail. First, I'd like to take a moment to highlight a few market dynamics we saw during the quarter.

With increased certainty around the political landscape, progress around the vaccine rollout, the reopening of businesses and various companies returning to work, we have seen institutional investors re-engage with our index options and volatility products this year. Quarter-over-quarter volume increased by 63% in VIX futures, 29% in VIX options and 15% in SPX options.

In Europe, our successful Brexit transition, and the reintroduction of Swiss trading on our UK market helped us achieve some notable records across our suite of European equity products during the first quarter. Cboe Europe Periodic Auctions had record average daily notional value traded of 1.3 billion Euros during the first quarter, up 5% year-over-year. Additionally, Cboe LIS, our European block trading platform powered by BIDS, had record market share of 24.1%, up from 22.7% market share one year ago. As clients have recalibrated their models and re-adjusted to the new trading landscape in Europe, we're pleased to see that our overall market share has increased to 17.9% month-to-date in April, our highest since July 2020.

We are maintaining our focus on investing in long-term growth, building on the strong foundation we laid last year and are excited about the momentum we are seeing across our business. Last month we announced plans to acquire Chi-X Asia Pacific, which will provide Cboe with a single point of entry into two of the world's largest securities markets – Australia and Japan. I'll touch on this exciting deal in a moment, but first let me update you on the key incremental growth drivers I noted earlier and how this planned acquisition complements several of these growth initiatives.

I'll begin with the progress we've made growing non-transaction revenues. During the first quarter, we achieved 17% growth in recurring non-transaction revenues, exceeding our expectations. This increase includes organic growth of 14%. Brian will share additional details later in the call, but we are increasing our 2021 growth target for organic recurring non-transaction revenues to a range of 10 to 11% from a range of 6 to 7%.

One of our top priorities remains the continued global expansion of our data and analytics offering and last month we announced the creation of Cboe Data and Access Solutions, a new division that will lead our charge to become a global leader in data and analytics.

Led by Catherine Clay, this new division combines our Information Solutions and Market Data and Access Services teams into one group to create an optimized offering for our global client base. This holistic solution is expected to enable customers around the world to seamlessly access all of Cboe's expanded capabilities, including global indices, interface solutions, as well as data, market and risk analytics, through a unified offering.

Additionally, in connection with the planned Chi-X acquisition, Cathy will lead our effort to build the first truly global equities market data platform that is expected to offer data from most major markets around the world.

We recognize that as the trading environment becomes more globalized, customers want greater efficiency in the market infrastructure services they require, and our goal is to align our business to address these client needs for global data and analytics. We are excited about the continued evolution of this business and believe the new Data and Access Solutions group will create opportunity to further grow our base of recurring non-transaction revenue. Cathy is a tremendous leader with a track record of delivering results and we're excited for her to lead this team as we look to expand the business and our market data offering globally.

Turning to Cboe Europe Derivatives, yesterday we announced plans to go live with this new market on Monday, September 6th, subject to regulatory approval. We had originally hoped to launch this new venue in June and while we expect to be operationally ready, the regulatory approval process has taken longer than expected given this initiative expands our existing clearing capabilities into a new asset class. We are working closely with regulators and continue to have a very constructive engagement with them. Most importantly, we have a critical mass of key market participants ready to support the exchange from day one including banks, clearing firms, market makers and proprietary trading firms who will help contribute to the provision of liquidity and client order flow on the new market.

The team has worked incredibly hard to achieve our mission of creating a modern, vibrant pan-European derivatives market designed to grow the overall derivatives trading landscape, while creating new opportunities for customers to express their investment views and manage their equity exposure. Our pan-European model will help provide market participants with the ability to access a modern, on-screen derivatives market through one single access point, creating efficiencies in trading and clearing.

As previously noted, while our 2021 revenue expectations for European derivatives are modest, we are investing for long-term growth and looking for a gradual revenue build as we gain traction, expand our product offering and unlock the potential we see for considerable growth in this market.

Moving to BIDS Trading, we see significant opportunity to leverage the planned Chi-X Asia Pacific acquisition to bring BIDS' industry-leading block trading capabilities to this new geography. With BIDS' current network covering major North American and European equities markets, the planned addition of Asia Pacific equities is expected to create a global block trading platform to serve a broader base of customers.

The expansion of BIDS into Canada is well underway alongside Cboe's technology integration of MATCHNow, the Canadian ATS we acquired last year. With BIDS' extensive global network of more than 460 buy-side investment managers and sell-side-constituents, this innovative platform will play a critical role in achieving Cboe's mission of building one of the world's largest global derivatives and securities trading networks.

We also remain committed to extending access to our products and services through product innovation, enhancement of our markets, as well as expansion of our customer base – both institutional and retail – and made solid progress on this initiative in the first quarter. Last month we extended equity trading hours on our EDGX Exchange to allow for trading beginning at 4:00 am Eastern Time and the volume we are handling during this early market session has exceeded our expectations. EDGX is now handling more than 11% of the volume during the early trading session.

Earlier this month we also received approval from the SEC to launch our innovative Periodic Auctions in the U.S., paving the way for us to provide customers with an on-exchange alternative to off-exchange electronic block trading by enabling them to trade in size, while helping to reduce market impact. As I mentioned earlier, we continue to see strong customer adoption of a related product in Europe and we're excited to build on its success by providing a new version of this product to our U.S. customer base. This long-awaited approval in the U.S. was the result of our steadfast commitment to improving markets for our customers, and we look forward to launching this offering in the third quarter of this year.

We are also planning to extend global trading hours for VIX and SPX options in the fourth quarter of this year, as part of our 24x5 initiative, subject to regulatory review. The lengthened global trading hours will complement our planned entry into Asia Pacific and are designed to help meet growing investor demand for the ability to manage risk more efficiently, react to global macroeconomic events as they are happening and adjust SPX and VIX options positions around the clock.

The uptick in market engagement from retail and institutional investors alike reinforces the importance our of ongoing commitment to education. Our new core derivatives curriculum from the Options Institute has been met with positive feedback from early participants at all experience levels.

We have expanded the Derivatives Education Webinar Series to include foundational knowledge on options pricing models and strategies and we are on track to launch our first set of online on-demand courses in June, to further build understanding of derivatives strategies and applications.

Additionally, to meet customer demand for even more learning opportunities, the Options Institute is expected to be launching the Adjunct Faculty Program this June. The program features distinguished practitioners specializing in derivatives products, operations and risk management, decision theory, and research.

Turning now to our plans to acquire Chi-X Asia Pacific. We believe this deal significantly advances our mission to build one of the world's largest global derivatives and securities trading networks, enabling the further extension of our product offerings to our global network of customers. We believe this exciting investment will complement our North American and European operations and provide a foothold in the key Asia Pacific region, positioning us to become a truly global marketplace for our customers.

Chi-X is one of the most successful alternative market operators in Asia Pacific, with core exchange operations in Australia and Japan, and a significant sales presence in the region.

Asia Pacific is an untapped market for Cboe, and we are excited about the potential to offer our unique proprietary products and other services to clients in the region. As I noted earlier, the acquisition provides the opportunity for us to expand our global equities business, including bringing BIDS to the region.

David Howson, President of Cboe's European and Asia Pacific operations, will lead our planned expansion into the region, working closely with the global Cboe team and the Chi-X local management teams.

Chi-X leadership has shown an incredible commitment to innovation across market operations, customer service and technology – and I look forward to leveraging the expertise of the team to expand Cboe's geographic reach, enhance existing capabilities and offer new market solutions to investors in the region.

The transaction is expected to close in the second or third quarter of 2021, subject to regulatory review and other customary closing conditions. We look forward to welcoming the Chi-X team into the Cboe Global Markets family.

With that, I'll 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 1Q21 as compared to 1Q20 and are based on our non-GAAP adjusted results.

As Ed just indicated, we reported strong financial results for the quarter – our third highest quarter on an adjusted EPS basis. Earnings were down compared to last year's record high, but we continued to build on the positive momentum we ended last year with. We also continued to execute on our strategic initiatives and remain laser focused on building one of the world's largest global derivatives and securities networks to deliver enhanced value to our customers as well as our shareholders. Now, a quick review of the quarter:

- Our net revenue increased 2%, with net transaction fees down 7% and recurring non-transaction revenue up 17%;
- Adjusted operating expenses increased 26%;
- Adjusted EBITDA of $250 million was down 6%;
- And finally, our adjusted diluted earnings per share was $1.53, down 7% compared to last year's record quarterly results but up 26% quarter-over-quarter.

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 revenue decline in our options segment was driven by lower trading volumes in our proprietary products, offset somewhat by:
  - a continuation of strong trading in our multi-listed options,
  - growth in revenue per contract (RPC) in our index and multi-listed options, and
  - growth in our recurring non-transaction revenue.
- The increase in North American equities revenue resulted from the addition of BIDS and MATCHNow, which contributed total revenue of $12.4 million. In addition, recurring non-transaction revenue increased nearly $5 million or 16%, with organic growth of 15%.
- The revenue decline in Futures resulted from lower trading volume in VIX futures.
- The revenue increase in Europe primarily reflects the addition of EuroCCP, which contributed $12.1 million. As Ed noted, we achieved some notable records in European Equities in the first quarter, underscoring our successful Brexit transition and the reintroduction of Swiss trading on our market and continued to make meaningful progress on the planned launch of European Derivatives. Overall, we are very proud of the European results this quarter given the challenging circumstances.
- And finally, in FX, the revenue decline was due to lower ADNV resulting in lower net transaction fees, offset slightly by growth in access and capacity fees. In addition, FX market share grew 80 basis points year-over-year to 16.5%.

While not included in our prior year results, I want to point out that the businesses we acquired in 2020 achieved double-digit year-over-year revenue growth, apart from BIDS, which had tougher comparisons, like our other trading venues.

We recently published historical volume and revenue capture metrics for EuroCCP, BIDS Trading and MATCHNow, which are available on our website where we post our monthly volume statistics.

Turning to expenses, total adjusted operating expenses were about $125 million for the quarter, up 26% against last year's first quarter. Excluding the impact of acquisitions, adjusted operating expenses were up 8% or $8 million for the quarter. Most of the expense variance related to the acquisitions was compensation and benefits.

While first quarter expenses annualized are tracking below our current expense guidance range of $531 to $539 million, most of the variance is due to shifts in timing, so we are reaffirming our previous guidance for 2021 expenses.

As we mentioned on our last earnings call, our plans for 2021 and beyond call for continued investments to drive long-term sustainable growth in our business. We started the year strong, achieving 14% organic growth in recurring non-transaction revenue, well ahead of our targeted growth rate for the year of 6 to 7%. Like prior quarters, most of this growth was driven by additional units or subscriptions versus pricing changes. As Ed mentioned, we now expect the organic annual growth rate in recurring non-transaction revenue to be 10 to 11% for the year. After incorporating our 2020 acquisitions, we similarly now expect the total annual growth rate for this category to be 11 to 12%, up from our prior guidance of 7 to 8%. As a reminder, we define recurring non-transaction revenue as access and capacity fees plus proprietary market data fees.

In the aggregate, we continue to expect the acquisitions closed in 2020 to contribute additional annual net revenue growth of 4 to 6% in 2021.

Expense Guidance:

Moving to our expense guidance, as I noted earlier, we continue to expect adjusted operating expenses to be in a range of $531 to $539 million.

Furthermore, I want to re-emphasize our plan to invest approximately $24 to $26 million this year to drive incremental and sustainable long-term organic revenue growth in high-conviction, high-return opportunities. This includes our European Derivatives buildout, as well as investments to increase access to our existing products and services, especially growth in our index options and futures by:

1. Developing, listing, and distributing unique products
2. Enhancing our marketing, education, and content, and
3. Increasing our efforts to tap into the growing base of retail investors.

Keep in mind, our current guidance metrics for 2021 do **not** include the pending acquisition of Chi-X. We will update our guidance accordingly once that transaction has closed.

Turning now to a summary of full-year guidance on the next slide, we are reaffirming our guidance for depreciation and amortization, effective tax rate on adjusted earnings and cap-ex.

2021 Tax Rate and Guidance

A quick note on our effective tax rate, which was 27.9% for the quarter, slightly above last year's first quarter rate of 27.0% and at the lower end of our guidance range of 27.5% to 29.5% We are reaffirming this guidance under the current tax laws.

Interest Expense

While we are not providing full year guidance on interest expense, absent any additional borrowing and significant changes to LIBOR, our interest expense for the second quarter of 2021 is expected to be $12.0 - $12.5 million, in line with our first quarter expense of $12.3 million.

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, our recent acquisitions as well as our pending acquisition of Chi-X underscore our conviction in our ability to deploy capital to help enhance organic growth and strategic value over time, leveraging the robust infrastructure and technology at the core of our strong operating leverage profile. From a capital return perspective, our strong cash flow generation enabled us to return $93 million to shareholders through dividends and share repurchases in the first quarter. We plan to continue being opportunistic with share repurchases.

Our leverage ratio was unchanged at 1.4 times at March 31 versus year-end 2020. We ended the year with adjusted cash of $264 million, reflecting in part, higher balances associated with additional regulatory capital supporting growth in Europe.

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 Closing Comments

Thank you, Brian. In closing, I am very pleased at the progress we have made as we continue to execute against our strategic growth plan and focus on building one of the world's largest global derivatives and securities networks.

Earlier this week Cboe celebrated its 48th anniversary. The pioneering spirit that drove the creation of our company now fuels our leadership as a global multi-asset market operator. While every year has been remarkable in its own right, the unprecedented events of this past year have reaffirmed what I already knew, the entrepreneurial and collaborative team spirit that has always defined Cboe has never been stronger.

I am very proud of what we have accomplished as a team and I look forward to delivering on our vision as the year progresses.

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

Debbie Koopman, Q&A Introduction

At this point, we would be happy to take questions. We ask that you please limit your questions to one per person to allow time to get to everyone. Feel free to get back in the queue and if time permits, we'll take a second question.

Closing: That completes our call this morning. We appreciate your time and continued interest in our company.

projections about the future other than statements of historical fact are forward-looking statements. These forward-looking statements, which are subject to known and unknown risks, uncertainties and assumptions about us, may include projections of our future financial performance based on our growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from those expressed or implied by the forward-looking statements.

We operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible to predict all risks and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Some factors that could cause actual results to differ include: the impact of the novel coronavirus ("COVID-19") pandemic, including changes to trading behavior broadly in the market; the loss of our right to exclusively list and trade certain index options and futures products; economic, political and market conditions; compliance with legal and regulatory obligations; price competition and consolidation in our industry; decreases in trading and clearing volumes, market data fees or a shift in the mix of products traded on our exchanges; legislative or regulatory changes; our ability to protect our systems and communication networks from security risks, cybersecurity risks, insider threats and unauthorized disclosure of confidential information; increasing competition by foreign and domestic entities; our dependence on and exposure to risk from third parties; fluctuations to currency exchange rates; our index providers' ability to maintain the quality and integrity of their indexes and to perform under our agreements; our ability to operate our business without violating the intellectual property rights of others and the costs associated with protecting our intellectual property rights; our ability to attract and retain skilled management and other personnel; our ability to minimize the risks, including our credit and default risks, associated with operating a European clearinghouse; our ability to accommodate trading and clearing volume and transaction traffic, including significant increases, without failure or degradation of performance of our systems; misconduct by those who use our markets or our products or for whom we clear transactions; challenges to our use of open source software code; our ability to meet our compliance obligations, including managing potential conflicts between our regulatory responsibilities and our for-profit status; our ability to maintain BIDS Trading as an independently managed and operated trading venue, separate from and not integrated with our registered national securities exchanges; damage to our reputation; the ability of our compliance and risk management methods to effectively monitor and manage our risks; our ability to manage our growth and strategic acquisitions or alliances effectively; restrictions imposed by our debt obligations and our ability to make payments on or refinance our debt obligations; our ability to maintain an investment grade credit rating; impairment of our goodwill, long-lived assets, investments or intangible assets; and the accuracy of our estimates and expectations. More detailed information about factors that may affect our actual results to differ may be found in our filings with the SEC, including in our Annual Report on Form 10-K for the year ended December 31, 2020, and other filings made from time to time with the SEC.

We do not undertake, and we expressly disclaim, any duty to update any forward-looking statement whether as a result of new information, future events or otherwise, except as required by law. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof.

This presentation includes market share, financials and industry data that we obtained from industry publications and surveys, reports of governmental agencies, third-parties and internal company surveys. Industry publications and surveys generally state that the information they contain has been obtained from sources believed to be reliable, but we cannot assure you that this information is accurate or complete. We have not independently verified any of the data and financials from third-party sources nor have we ascertained the underlying economic assumptions relied upon therein. Statements as to our market position are based on the most currently available market data. While we are not aware of any misstatements regarding industry data and financials presented herein, our estimates involve risks and uncertainties and are subject to change based on various factors.