Cboe Global Markets, Inc.
Third Quarter 2021 Earnings Call - Prepared Remarks
October 29, 2021

Slide 1: Title

Operator: Good morning everyone, and welcome to Cboe Global Markets' third quarter 2021 earnings conference call.

At this time, for opening introductions, I would like to turn the call over to Ken Hill, Vice President of Investor Relations.

Slide 2: Agenda- Ken Hill

Good morning and thank you for joining us for our third 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 an update on our 2021 financial outlook. Following their comments, we will open the call to Q&A. Also joining us for Q&A will be Chris Isaacson, our Chief Operating Officer and John Deters, our Chief Strategy Officer.

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.

Slide 3: Forward-Looking Statements

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 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.

Slide 4: Ed Tilly, CEO

Thank you, Ken. We're happy to have you on board as Debbie Koopman prepares for retirement next month.

Good morning and thank you for joining us today. As we head into year-end, I hope that you are doing well and remaining safe and healthy.

Slide 5: Solid Financial Results, With Revenue Growth Across All Business Segments

I am pleased to report on solid financial results for the third quarter of 2021 at Cboe Global Markets.

For the quarter, we reported revenue growth across each of our business segments, reflecting strong year-over-year increases in both transaction and recurring non-transaction revenues, with net revenue up 27% and adjusted EPS up 31%.

Our solid third-quarter results were driven by higher volumes in our index options and volatility products, increased demand for our suite of data and access solutions, and growth in trading volumes across nearly all our segments. In our proprietary products, ADV increased by 29% in VIX futures, 32% in VIX options and 39% in SPX options. We also continued to see strong growth in multi-listed options trading with ADV up 20% year-over-year in the third quarter.

During the quarter, we also delivered on several strategic milestones to expand our global network, including the successful launch of our European Derivatives platform, as well as the closing of our acquisition of Chi-X Asia Pacific. I'll touch on both in a moment, but first I want to discuss our plans to enter the digital asset market through the planned acquisition of ErisX, which we announced last week. ErisX will provide Cboe with spot trading, data, derivatives, and clearing capabilities for digital assets through its regulated futures exchange and clearing house.

Slide 6: Cboe Plans to Enter the Digital Asset Market Through Acquisition of ErisX

The last two weeks have been a watershed moment for the digital asset industry with the launch of trading in the first bitcoin ETF in the U.S. equities market. As the appetite for ownership in digital assets continues to grow, we believe Cboe can play a guiding role in shaping the trajectory of this revolutionary market. Today, we are at a critical inflection point – we're seeing strong retail demand, institutional interest, market growth and the mainstreaming of digital assets even with traditional financial firms. As a leading provider of global market infrastructure and tradable products, we can bring the knowledge, structure and transparency of our trusted markets to the digital asset space. The demand and excitement for digital assets is driven by the unique market structure and freedom it affords, and we want to maintain that innovative spirit while providing the regulatory framework and structure that many market participants desire.

We have secured support from a tremendous group of industry leaders who are aligned with our vision and want to shape and define this asset class now, and for the future. These industry leaders bring different perspectives and expertise, from retail brokers, crypto-leading firms, global liquidity providers, and sell-side banks. They are expected to form a Digital Advisory Committee tasked with advising us on the ongoing development of our digital asset business, Cboe Digital. These industry leaders include DRW, Fidelity Digital Assets, Galaxy Digital, Interactive Brokers, NYDIG, Paxos, Robinhood, Virtu Financial and Webull. Additionally, certain members of the Digital Advisory Committee intend to acquire minority ownership interests in Cboe Digital.

I am confident that together with ErisX CEO Tom Chippas and his team and our incredible partner group, we can not only meet the growing demand for institutional and retail trading solutions, but also push the boundaries of digital asset innovation and unlock its next phase of growth.

Slide 7: Strategic Momentum - Investing in Long-Term Growth

I’m extremely pleased with the progress we made during the third quarter executing on the four key incremental growth drivers I outlined at the beginning of this year – the opportunity to grow recurring non-transaction revenue, the launch of Cboe Europe Derivatives, our expansion plans for BIDS Trading, and extending access to our products and services across geographies and market participants.

We saw positive momentum in our Data and Access Solutions again this quarter, fueling a 21% increase in our recurring non-transaction revenue. This growth was driven by continued demand for access to our exchanges, proprietary market data and new subscribers to Cboe’s front-end platforms, including Silexx and TradeAlert.

We continue to optimize the efficiency and delivery of our data and access solutions to market participants and are excited to launch Cboe Global Cloud, a new real-time, cloud-based market data streaming service in collaboration with Amazon Web Services, on November 1. Cboe Global Cloud is expected to help further extend Cboe’s data to new users and geographies – an important step towards broadening investor access to our proprietary content and market data globally.

Turning now to Europe where we successfully launched our European Derivatives market on September 6th. We are very pleased with the initial progress with trading and clearing running smoothly as we slowly build volume. Over the coming months we plan to introduce additional products and onboard new participants. Bringing the first truly pan-European, transparent and lit derivatives market to Europe is a remarkable achievement and we are enthusiastic about the opportunities ahead.

Additionally, our European equities business delivered strong results in the third quarter with average daily notional value traded up 29%. Cboe LIS, powered by BIDS, continued to see positive momentum and, for the first time in its history became the largest block trading platform in Europe for the month of August. BIDS has established itself as the premier block trading destination in the U.S. and Europe and we are excited about our plans to expand the BIDS network to Canada early next year, and then the Asia Pacific region, to serve an even broader base of customers.

Turning to Asia-Pacific, we've made good progress integrating the Chi-X teams since we closed the acquisition at the beginning of July. We plan to migrate Chi-X to Cboe technology and are busy working through the integration plan and timeline.

With our expanded footprint in the Asia-Pacific region, we see a significant opportunity to further develop our ecosystem of market infrastructure and tradable products into one of the world's largest global derivatives and securities networks.

Beginning November 21st, we plan to take an important step towards broadening our network and access to our proprietary products through the launch of extended global trading hours for VIX and SPX options, as part of our 24-by-5 initiative. The lengthened global trading hours complement our entry into Asia Pacific and are designed to help meet growing investor demand for the ability to manage risk more efficiently and adjust SPX and VIX options positions around the clock.

We are also pleased to announce that Webull, a leading retail broker platform with a growing global presence, began offering our proprietary products – VIX and SPX options – on their platform this month.

We've continued to see strong demand for SPX options from both institutional and retail broker platforms and are eager to expand access to this product suite. Similar to last quarter, we saw solid growth in SPX options trading on retail broker platforms with ADV on those platforms up 24% from the second quarter, hitting a new all-time high.

Key to our global network expansion are strong partnerships, and, to that end, we were thrilled to expand our relationship with MSCI and extend the licensing agreement that allows Cboe to offer options trading on MSCI global indices through 2031. We have valued our strong relationship with MSCI for many years and we look forward to further collaboration in the years ahead, particularly in the important area of ESG investing.

Slide 8: Launch of Nanos by Cboe

As the retail market continues to grow, we remain committed to investing in education and product development to meet their unique needs. To that end, earlier this week we announced plans to launch Nanos – a first of its kind options contract designed to make trading more accessible for the retail trader.

Increased retail participation has fueled record trading across the industry. Between the top four retail broker platforms there are now more than 150 million retail brokerage accounts, and many of these accounts are too small to take advantage of the potential benefits certain options contracts can offer.

We plan to launch our first nanos product on the S&P 500 index in first-quarter 2022. At a fraction of the size of a standard options contract, the one-multiplier, cash-settled nano-S&P 500 answers the growing demand for a simpler, more cost-effective way to gain broad exposure to the US equity market.

The S&P 500 options market is one of the most highly traded and liquid options markets across the globe. Through our Nanos S&P 500 product, we are broadening access to a greater universe of traders who can enjoy the potential benefits options provide including hedging, asset allocation, and income generation strategies.

To complement the launch of Nanos, the Cboe Options Institute plans to offer a new options introductory curriculum tailored to retail traders. Through our long-standing commitment to education, we are continuously evolving our programs to offer more retail-centric content through the Options Institute, and we look forward to welcoming a new generation of traders to options trading with the launch of Nanos.

Slide 9: Expanding Cboe's Ecosystem of Market Infrastructure and Tradable Products

As we broaden our global footprint by entering new markets and launching new products and services, we further our goal of expanding access to a broader base of customers – both institutional and retail. By leveraging our technological expertise, customer relationships, and capital markets capabilities, we plan to continue to unlock additional revenue opportunities across our businesses.

We head into the final months of the year on stronger footing than ever, and we look forward to continuing to execute on our growth opportunities ahead.

With that, I'll turn it over to Brian.

Slide 10: Brian Schell Title Slide

Thanks Ed, and good morning everyone. Let me remind everyone that unless specifically noted, my comments relate to 3Q21 as compared to 3Q20 and are based on our non-GAAP adjusted results.

Slide 11: 3Q Financial Summary

As Ed just indicated, the third quarter was incredibly strong for Cboe with robust results from both a transaction and non-transaction basis. Overall adjusted earnings increased 31% versus the third quarter of 2020 and improved off solid second quarter 2021 metrics. As we move forward, we look for the cash, derivatives and data portions of our business to work in unison to enhance revenue opportunities and shareholder value. Now a quick look at the third quarter:

- Our net revenue increased 27%, setting a new quarterly record; net transaction fees were up 39% and recurring non-transaction revenue was up 21%;
- Adjusted operating expenses increased 29%;
- Adjusted EBITDA of $240 million was up 25%;
- And finally, our adjusted diluted earnings per share was $1.45, up 31% compared to last year's quarterly results.

Slide 12: 3Q21 Net Revenue by Segment and Key Drivers

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:

- While we saw year-over-year growth in all of our segments, our options segment produced above average growth for the quarter of 30%, driven by higher trading volumes and revenue per contract (RPC) in both our proprietary and multi-listed options:

- Total options ADV was up 23% as we saw double digit increases in both index and multi-listed options,
- Revenue per contract (RPC) also moved higher by 16% given positive mix shift to index products and a strong increase in our multi-listed options RPC, up 23%, and
- We continued to benefit from double-digit growth in recurring non-transaction revenue, particularly access and capacity fees.

- North American equities revenue increased 13% year-over-year as acquisition-related net-transaction and clearing fees were further helped by strong proprietary market data fees and access and capacity fees. This was offset somewhat by a 1% year-over-year decline in U.S. equity ADV and a 1% year-over-year decline in market share for the quarter. While market share trends have been impacted by aggressive pricing trends from some competitors, we remain focused on optimizing long-term profit in the business through the many initiatives we have introduced, or plan to introduce, to the market. For the quarter, MATCHNow and BIDS contributed $8.5 million in net revenue. Lastly, recurring non-transaction revenue increased by more than $5 million or 17%, with organic growth of 14%.
- Third quarter revenue increased in Futures by 24% on the back of a 30% increase in ADV and a 6% increase in capture. Looking forward, we were pleased to see the SEC recently approve filings to list and trade shares of two new Volatility Shares' products: an inverse and a long VIX Futures ETF. These new listings are likely to increase the VIX trading ecosystem as the AUM builds on those products.
- The revenue increase in Europe and APAC primarily reflects the addition of Chi-X Asia Pacific in July 2021, an $8.2 million contribution, as well as growth in European equities and clearing. Underlying trends remained strong in the third quarter as Industry average daily notional value traded, market share on Cboe European Equities, and net capture all moved higher on a year-over-year basis.
- And finally, revenues in the FX segment increased 8% as compared to the third quarter of 2020 as trading volumes and net capture moved higher. During the quarter Global FX market share hit a new all-time high of 17 percent.

Slide 13: Grew Recurring Non-Transaction Revenue 21% YoY

Cboe's recurring non-transaction revenue growth remained elevated in the third quarter with YoY organic growth reaching 14%. Again, this strong growth was largely a product of additional subscriptions and units as opposed to price increases. More specifically we saw:

- Both physical and logical port usage remained robust in our equities and options businesses driven by increased demand for trading capacity.
- And on the market data side, the equities top-of-book and depth of book products continue to perform well.

We are increasing our organic growth outlook by 1 to 2 percentage points to approximately 14%. Our total recurring non-transaction revenue growth is now expected to reach approximately 18% for 2021, up 2 to 3 percentage points vs. our prior expectation. Overall, we are very pleased with the continued traction in this business as it an important element of Cboe's ecosystem of products.

Slide 14: 3Q21 Adjusted Operating Expenses Up 29%, Primarily Driven by Acquisitions

Turning to expenses, total adjusted operating expenses were approximately $140 million for the quarter, up 29% compared to last year. Excluding the impact of acquisitions owned less than a year, adjusted operating expenses were up 17% or $19 million for the quarter. Most of the expense variance related to the acquisitions was compensation and benefits.

Slide 15: Adjusted Operating Expense Bridge 2020 to 2021

Expense Guidance

Moving to our expense guidance, we are tightening and raising our expense guidance range for the full year to $536 to $541 million from $531 to $539 million. The $4 million increase in the midpoint reflects higher incentive compensation costs reflecting the strong year-to-date operating results we have posted, as well as our plans for increased hiring during the fourth quarter, and a slight uptick in our depreciation and amortization forecast. As a firm, we believe in a pay-for-performance culture and not only has our year-to-date financial performance been strong, we have made significant progress against our longer term growth priorities, especially towards increasing access to Cboe products and services – as Ed noted previously.

As you recall from our February earnings meeting, we laid out a path for revenue growth that would be preceded by higher-than-normal expense growth that would slightly compress margins in the short-term to enable longer term growth. We remain focused on investing in key initiatives with attractive returns and we look forward to meeting the current and future market demand by prudently investing organically and inorganically to meet those needs, even if it requires upfront spend.

Slide 16: Updated Guidance Reflects Higher Growth Rate in Non-Transaction Revenue and Projected Performance-based Compensation

Now turning to a summary of full-year guidance on the next slide, we are raising our guidance for depreciation and amortization to $38 to $42 million from $34 to $38 million due to the earlier timing of various projects. Our cap-ex guidance range moves $8 million lower to $47 to $52 million, and we are reaffirming the higher end of our guided tax rate range of 27.5% to 29.5%, for the full year <u>under the current tax laws.</u>

Interest Expense

Our interest expense for the third quarter of 2021 was $11.7 million. We expect our fourth quarter interest expense to hold steady in the $11.5 - $12.0 million range.

Slide 17: Focused on Efficient Allocation of Capital to Create Long-Term Shareholder Value

In addition to the investment priorities we outlined earlier in the call, we remain committed to returning excess cash to shareholders through dividends and share repurchases. From a capital return perspective, our strong cash flow generation enabled us to raise our quarterly dividend for the 11th straight year, growing 14% on a year-over-year basis. In total, we returned $52 million to shareholders through dividends in the third quarter.

Our leverage ratio decreased slightly versus the prior quarter to 1.4x at September 30 as our debt levels remained steady on a sequential basis. Overall, our balance sheet remains unencumbered as we look to put incremental capital to use in value enhancing ways for shareholders. Our adjusted cash and financial investments balance is elevated reflecting the planned use of cash to fund a portion of the planned transactions we recently announced as well as a slightly higher requirement for regulatory capital purposes.

Slide 18: Well Positioned to Continue Growth in 2021 and Beyond

In summary, Cboe delivered a very strong third quarter and we are even more enthusiastic about the number of high-quality growth initiatives we are bringing into our ecosystem:

- solutions that extend access to global markets for our customers,
- grow our geographic footprint and breadth of asset classes, and
- diversify our revenue base.

We look for these planned additions to fuel continued growth across the Cboe ecosystem.

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

Slide 19: ESG Overview

Closing Remarks:

Thanks, Brian. Before we move to Q&A, I also want to provide a further update on our ESG initiatives during the quarter. Earlier this month, Cboe was proud to be named a founding member of the derivatives partner exchanges network of the United Nations Sustainable Stock Exchanges initiative. We look forward to sharing ideas and engaging this network on important dialogue on how derivative exchanges can support greater sustainability, in addition to advancing partnerships with index leaders in this important space.

As you can see, we have been extremely busy and I thank the entire Cboe team for their hard work delivering outstanding results. We look forward to hosting our Investor Day on November 16th where we will dive further into our business providing more color on these initiatives and how they are helping drive our strategy. We hope that you can join us, details for accessing the event are on our IR website.

Finally, I'd once again like to thank Debbie Koopman for her service and wish her all the best as she heads into retirement next month. She'll be with us through Investor Day so it's not quite farewell yet, but this is her finale for quarterly earnings. She will be dearly missed by me and the entire Cboe team.

I'll now pass it back to Ken for instructions on the Q&A portion of the call.

Slide 20: Q&A

Ken Hill

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.

Cautionary Statements Regarding Forward-Looking Information and Trademarks:

This presentation contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve a number of risks and uncertainties. You can identify these statements by forward-looking words such as "may," "might," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential" or "continue," and the negative of these terms and other comparable terminology. All statements that reflect our expectations, assumptions or 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.

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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 or change in tax regimes; 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; factors that impact the quality and integrity of our indices; 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.

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