CHICAGO MERCANTILE EXCHANGE HOLDINGS INC
Form 10-Q
November 04, 2005
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2005

- OR -

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ______

Commission file number 001-31553

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-4459170**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
20 South Wacker Drive, Chicago, Illinois	**60606**
(Address of principal executive offices)	**(Zip Code)**

(312) 930-1000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

The number of shares outstanding of each of the registrant s classes of common stock as of October 28, 2005 was as follows: 34,474,589 shares of Class A common stock, $0.01 par value; 625 shares of Class B common stock, Class B-1, $0.01 par value; 813 shares of Class B common stock, Class B-2, $0.01 par value; 1,287 shares of Class B common stock, Class B-3, $0.01 par value; and 413 shares of Class B common stock, Class B-4, $0.01 par value.

Table of Contents

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC.

FORM 10-Q

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

From time to time, in written reports and oral statements, we discuss our expectations regarding future performance. Forward-looking statements are based on currently available competitive, financial and economic data, current expectations, estimates, forecasts and projections about the industries in which we operate and management s beliefs and assumptions. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or implied in any forward-looking statements. We want to caution you to not place undue reliance on 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. Among the factors that might affect our performance are:

- increasing competition by foreign and domestic competitors, including new entrants into our markets;
- our ability to keep pace with rapid technological developments, including our ability to complete the development and implementation of the enhanced functionality required by our customers;
- our ability to continue introducing competitive new products and services on a timely, cost-effective basis, including through our electronic trading capabilities, and our ability to maintain the competitiveness of our existing products and services;
- our ability to efficiently and simultaneously operate both open outcry trading and electronic trade execution facilities;
- our ability to adjust our fixed costs and expenses if our revenues decline;
- our ability to continue to realize the benefits of our transaction processing agreement with the Chicago Board of Trade;
- our ability to maintain existing customers and attract new ones;
- changes in domestic and foreign laws and regulations;
- changes in government policy, including policies relating to common or directed clearing;
- the costs associated with protecting our intellectual property rights and our ability to operate our business without violating the intellectual property rights of others;
- our ability to generate market data fees that may be reduced or eliminated by the growth of electronic trading;
- changes in our rate per contract due to shifts in the mix of the products traded, the trading venue and the mix of customers (whether the customer receives member or non-member fees or participates in one of our various incentive programs) and the impact of our tiered pricing structure;

the ability of our financial safeguards package to adequately protect us from the credit risks of our clearing members;

changes in price levels and volatility in the derivatives markets and in underlying fixed income, equity, foreign exchange and commodities markets;

economic, political and market conditions;

our ability to accommodate increases in trading volume without failure or degradation of performance of our systems;

our ability to execute our growth strategy and maintain our growth effectively;

our ability to manage the risks and control the costs associated with our acquisition, investment and alliance strategy;

industry and customer consolidation;

decreases in trading and clearing activity; and

seasonality of the futures business.

For a detailed discussion of these and other factors that might affect our performance, see Exhibit 99.1 to this Quarterly Report on Form 10-Q.

CME® Globex®, CME Alternative Marketplace, CME Auction Markets, CME Economic Derivatives and SPAN® are our registered trademarks. CME E-mini is our service mark. CLEARING 21® is a registered trademark of Chicago Mercantile Exchange Inc. and New York Mercantile Exchange, or NYMEX, pursuant to agreement. E-mini S&P 500® , S&P 500® , E-mini NASDAQ-100® , NASDAQ-100® , Russell® , TRAKRS℠ and other trade names, service marks, trademarks and registered trademarks that are not proprietary to us, are the property of their respective owners and used herein under license.

TRAKRS℠, Total Return Asset Contracts, are exchange-traded non-traditional futures contracts designed to provide market exposure to various market-based indexes which trade electronically on the CME Globex electronic platform. Clearing and transaction fees on these products are minimal relative to other CME products. Unless otherwise noted, disclosures of trading volume and average rate per contract exclude our TRAKRS products.

CME Economic Derivatives are options and forwards geared to seven key U.S. and European economic indicators that trade in an auction format. Clearing and transaction fees on CME Economic Derivative products are based on notional values rather than volume and are minimal relative to other CME products. Unless otherwise noted, disclosures of trading volume and average rate per contract exclude these products.

Table of Contents

Item 1. Financial Statements

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

(unaudited)

	September 30, 2005	December 31, 2004
Assets		
Current Assets:		
Cash and cash equivalents	$ 585,665	$ 357,562
Collateral from securities lending	1,222,688	1,582,985
Short-term investments of interest earning facilities	59,480	87,521
Marketable securities	242,146	302,429
Accounts receivable, net of allowance of $1,014 and $1,089	107,188	78,825
Other current assets	21,024	18,959
Cash performance bonds and security deposits	536,568	269,919
Total current assets	2,774,759	2,698,200
Property, net of accumulated depreciation and amortization of $279,787 and $266,640	144,865	131,361
Other assets	30,317	27,905
Total Assets	$ 2,949,941	$ 2,857,466
Liabilities and Shareholders Equity		
Current Liabilities:		
Accounts payable	$ 17,555	$ 23,045
Payable under securities lending agreements	1,222,688	1,582,985
Payable to participants in interest earning facilities	59,480	87,521
Other current liabilities	55,240	62,153
Cash performance bonds and security deposits	536,568	269,919
Total current liabilities	1,891,531	2,025,623
Other liabilities	19,339	19,246
Total Liabilities	1,910,870	2,044,869
Shareholders Equity:		
Preferred stock, $0.01 par value, 9,860,000 shares authorized, none issued and outstanding		
Series A junior participating preferred stock, $0.01 par value, 140,000 shares authorized, none issued and outstanding		
Class A common stock, $0.01 par value, 138,000,000 shares authorized, 34,425,289 and 34,098,623 shares issued and outstanding as of September 30, 2005 and December 31, 2004, respectively	344	341
Class B common stock, $0.01 par value, 3,138 shares authorized, issued and outstanding		
Additional paid-in capital	305,588	261,050
Retained earnings	736,000	552,801

Accumulated net unrealized securities losses	(2,861)	(1,595)
Total Shareholders Equity	1,039,071	812,597
Total Liabilities and Shareholders Equity	$ 2,949,941	$ 2,857,466

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(unaudited)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Revenues:				
Clearing and transaction fees	$ 519,744	$ 413,763	$ 176,330	$ 147,937
Clearing and transaction processing services	53,168	41,005	17,593	14,354
Quotation data fees	54,371	45,198	18,811	14,913
Access fees	14,123	11,893	4,637	3,924
Communication fees	6,824	7,579	2,232	2,523
Investment income	21,189	9,094	8,830	3,229
Securities lending interest income	39,537	11,892	15,714	4,492
Other	16,778	16,355	5,495	5,328
Total Revenues	725,734	556,779	249,642	196,700
Securities lending interest expense	(38,112)	(11,017)	(15,331)	(4,311)
Net Revenues	687,622	545,762	234,311	192,389
Expenses:				
Compensation and benefits	134,125	122,150	45,229	40,939
Occupancy	21,321	20,561	7,272	7,033
Professional fees, outside services and licenses	31,857	26,950	11,519	10,020
Communications and computer and software maintenance	42,190	36,923	14,791	12,008
Depreciation and amortization	48,118	39,466	17,256	13,555
Marketing, advertising and public relations	9,511	7,859	3,961	2,878
Other	17,863	18,288	5,992	6,077
Total Expenses	304,985	272,197	106,020	92,510
Income before income taxes	382,637	273,565	128,291	99,879
Income tax provision	(152,060)	(110,794)	(50,825)	(40,451)
Net Income	$ 230,577	$ 162,771	$ 77,466	$ 59,428
Earnings per Common Share:				
Basic	$ 6.73	$ 4.88	$ 2.25	$ 1.75
Diluted	6.63	4.74	2.22	1.72
Weighted Average Number of Common Shares:				
Basic	34,262	33,374	34,370	33,935
Diluted	34,793	34,330	34,891	34,496

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(in thousands, except share and per share data)

(unaudited)

	Class A Common Stock (Shares)	Class B Common Stock (Shares)	Common Stock and Additional Paid-in Capital	Retained Earnings	Accumulated Net Unrealized Securities Gains (Losses)	Total Shareholders Equity
Balance December 31, 2004	34,098,623	3,138	$ 261,391	$ 552,801	$ (1,595)	$ 812,597
Comprehensive income:						
Net income				230,577		230,577
Change in net unrealized loss on securities, net of tax of $802					(1,266)	(1,266)
Total comprehensive income						229,311
Exercise of stock options	299,435		9,355			9,355
Tax benefit related to employee option exercises and restricted stock vesting			25,916			25,916
Quarterly cash dividends on common stock of $0.46 per share				(47,378)		(47,378)
Vesting of issued restricted Class A common stock	24,998					
Issuance of Class A common stock to Board of Directors	2,233		476			476
Stock-based compensation			8,794			8,794
Balance September 30, 2005	34,425,289	3,138	$ 305,932	$ 736,000	$ (2,861)	$ 1,039,071
Balance December 31, 2003	32,922,061	3,138	$ 194,610	$ 368,312	$ 73	$ 562,995
Comprehensive income:						
Net income				162,771		162,771
Change in net unrealized loss on securities, net of tax of $499					(733)	(733)
Total comprehensive income						162,038
Exercise of stock options	996,444		2,245			2,245
Tax benefit related to employee option exercises and restricted stock vesting			43,341			43,341
Quarterly cash dividend on common stock of $0.26 per share				(26,205)		(26,205)
Vesting of issued restricted Class A common stock	24,200					
Stock-based compensation			5,235			5,235
Balance September 30, 2004	33,942,705	3,138	$ 245,431	$ 504,878	$ (660)	$ 749,649

See accompanying notes to unaudited consolidated financial statements.

7

Table of Contents

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2005	**2004**
Cash Flows from Operating Activities:		
Net income	$230,577	$162,771
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	48,118	39,466
Stock-based compensation	8,794	5,235
Change in deferred income taxes	(2,275)	4,192
Loss on investment in joint venture	2,217	2,798
Amortization of purchased intangibles	530	195
Amortization of net premiums on marketable securities	1,844	2,272
Loss on disposal of fixed assets	689	351
Change in allowance for doubtful accounts	(75)	404
Tax benefit related to employee option exercises and restricted stock vesting	25,916	43,341
Change in accounts receivable	(28,288)	(31,316)
Change in other current assets	735	6,246
Change in other assets	(2,921)	24
Change in accounts payable	(5,490)	(8,010)
Change in other current liabilities	(6,913)	2,656
Change in other liabilities	93	(3,230)
Net Cash Provided by Operating Activities	273,551	227,395
Cash Flows from Investing Activities:		
Purchases of property, net	(62,310)	(48,968)
Purchases of intangible assets	(643)	(4,818)
Capital contributions to joint venture	(844)	(900)
Purchases of marketable securities		(99,153)
Proceeds from maturities of marketable securities	56,372	49,408
Net Cash Used in Investing Activities	(7,425)	(104,431)
Cash Flows from Financing Activities:		
Cash dividends	(47,378)	(26,205)
Proceeds from exercised stock options	9,355	2,245
Payments on long-term debt		(1,349)
Net Cash Used in Financing Activities	(38,023)	(25,309)
Net increase in cash and cash equivalents	228,103	97,655
Cash and cash equivalents, beginning of period	357,562	185,124

Cash and Cash Equivalents, End of Period	$585,665	$282,779
Supplemental Disclosure of Cash Flow Information:		
Interest paid (excluding interest for securities lending)	$ 715	$ 1,888
Income taxes paid	125,669	61,876
Non-cash investing and financing activities:		
Gross unrealized securities losses	(2,068)	(1,232)

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying interim consolidated financial statements have been prepared by Chicago Mercantile Exchange Holdings Inc. (CME Holdings) without audit. Certain notes and other information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. In the opinion of management, the accompanying consolidated financial statements include all adjustments necessary to present fairly the financial position of CME Holdings as of September 30, 2005 and December 31, 2004, and the results of its operations and its cash flows for the periods indicated.

CME Alternative Marketplace Inc., a wholly owned subsidiary of Chicago Mercantile Exchange Inc. and an exempt board of trade registered with the Commodity Futures Trading Commission, was established for the trading of CME Economic Derivatives. CME Economic Derivatives are options and forwards geared to seven key U.S. and European economic indicators that trade in an auction format via CME Auction Markets and are cleared and guaranteed by CME. On September 29, 2005, CME cleared its first CME Economic Derivatives contract based on the weekly initial jobless claims number.

The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in Exhibit 13.1 of the Chicago Mercantile Exchange Holdings Inc. Annual Report on Form 10-K for the year ended December 31, 2004. Quarterly results are not necessarily indicative of results for any subsequent period.

Certain reclassifications have been made to the 2004 financial statements to conform to the presentation in 2005.

2. Performance Bonds and Security Deposits

Each firm that clears futures and options on futures contracts traded on Chicago Mercantile Exchange Inc. and its subsidiaries (CME or the exchange) is required to deposit and maintain specified performance bonds and security deposits principally in the form of cash, funds deposited in the various Interest Earnings Facility (IEF) programs, U.S. Government and certain foreign government securities or bank letters of credit. For the Chicago Board of Trade (CBOT) products cleared by CME, CME combines those positions with that clearing firm s CME positions to create a single portfolio for which performance bond and security deposit requirements are calculated. These performance bonds and security deposits are available to meet the financial obligations of that clearing firm to the exchange. In the event that performance bonds and security deposits of a defaulting clearing firm are inadequate to fulfill that clearing firm s outstanding financial obligation, the entire security deposit fund is available to cover potential losses after first utilizing operating funds of the exchange in excess of amounts needed for normal operations. Cash performance bonds and security deposits may fluctuate due to the investment choices available to clearing firms and the change in the amount of deposits required. As a result, these assets and offsetting liabilities may vary significantly over time. See Note 6 of Notes to Consolidated Financial Statements in Exhibit 13.1 to CME Holdings Annual Report on Form 10-K for the year ended December 31, 2004.

3. Guarantees

Interest Earning Facility. Clearing firms, at their option, may instruct CME to invest cash on deposit for performance bond or security deposit purposes in a portfolio of securities that is part of the IEF programs. The first IEFs were organized in 1997 as two limited liability companies. Interest earned, net of expenses, is passed on to participating clearing firms. The principal of the first IEFs, which totaled $59.5 million at September 30, 2005, is guaranteed by the exchange and is included in the accompanying consolidated balance sheets. The investment portfolios of these facilities are managed by an exchange-approved settlement bank and eligible investments include U.S. Treasury bills and notes, U.S. Treasury strips and reverse repurchase agreements. The maximum average portfolio maturity is 90 days and the maximum maturity for an individual security is 13 months. At September 30, 2005, all funds in the first IEFs were invested in overnight reverse repurchase agreements. If funds invested in these IEFs are required to be liquidated due to a clearing firm redemption transaction and funds are not immediately available due to lack of liquidity in the investment portfolio, default of a repurchase counterparty, or loss in market value, CME guarantees the amount of the redemption. Management believes that the market risk exposure relating to its guarantee is not material to the consolidated financial

Table of Contents

statements taken as a whole. Financial Accounting Standards Board Interpretation (FIN) No. 45, Guarantor s Accounting and Disclosure Requirements of Guarantees of Indebtedness of Others, requires that an entity (CME) issuing a guarantee recognize, at the inception of the guarantee, a liability equal to the fair value of the guarantee. CME has evaluated its requirements under FIN No. 45 and concluded that no material liability is required to be recorded. Management has decided to discontinue operation of the first IEFs in December 2005, at which time investments will be liquidated, balances returned to participants and CME s obligation under the guarantee will terminate.

Intellectual Property Indemnifications. Some agreements with customers accessing the CME Globex electronic platform and utilizing CME market data services, CME SPAN® software and CME CLEARING 21® clearing system contain indemnifications from intellectual property claims that may be made against them because of their use of these products. The potential future claims relating to these indemnifications cannot be estimated and, therefore, in accordance with FIN No. 45, no liability has been recorded.

4. Stock-Based Payments

In the first nine months of 2005, CME granted stock options totaling 220,800 shares to various employees under the CME Holdings Omnibus Stock Plan. The options vest over a five-year period, with 20% vesting one year after the grant date and on that same date in each of the following four years. The options have a ten-year term with an exercise price ranging from $196.83 to $301.30, the market prices at the grant dates. In accordance with Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended, the fair value of the options granted to employees totaled $22.0 million, measured at the grant dates using the Black-Scholes valuation model. A risk-free rate ranging from 3.9% to 4.3% was used over a period of 6 to 6.5 years with a volatility factor ranging from 33.6% to 42.8% and a dividend yield ranging from 0.6% to 0.9%. This compensation expense will be recognized on an accelerated basis over the vesting period.

In the first nine months of 2005, CME also granted 5,900 shares of restricted Class A common stock that have the same vesting provisions as the stock options granted at that time. Compensation expense of $1.5 million relating to this restricted stock will be recognized on an accelerated basis over the vesting period.

The following table summarizes stock option share activity for the period:

Options Outstanding at December 31, 2004	1,346,792
Granted	220,800
Exercised	(299,435)
Cancelled	(48,440)
Options Outstanding at September 30, 2005	1,219,717
Weighted Average Exercise Price of Options Outstanding at September 30, 2005	$ 98.01

At September 30, 2005, 519,487 of the outstanding options were exercisable.

In the second quarter of 2005, CME Holdings decreased the annual cash stipend of its non-executive members of the Board of Directors and added an equity component. As a result, CME Holdings issued 2,233 shares of Class A common stock to its non-executive directors under the 2005 Director Stock Plan. These shares are not subject to any vesting restrictions. Expense of $0.5 million related to this stock will be amortized over a one-year period.

At year-end 2002, CME adopted the fair value method for expensing stock options under the provisions of SFAS No. 123, as amended. In December 2004, the Financial Accounting Standards Board issued SFAS No. 123R (revised 2004), Share-Based Payment, which requires use of the fair value method of accounting for share-based payment transactions with employees. Under SFAS No. 123R, CME will be required to estimate expected forfeitures of stock grants instead of the current practice of accounting for forfeitures as they occur. In addition, CME will also begin to classify the excess tax benefits, if any, related to employee option exercises as financing activities rather than operating activities in the consolidated statements of cash flows. This requirement will reduce net operating cash flows and increase net financing cash flows in the periods after adoption. The future amounts of these benefits cannot be estimated as they are dependent on, among other things,

Table of Contents

when employees exercise stock options. CME plans to continue to use the Black-Scholes model to determine the fair value of stock option grants, which has been used since adopting the fair value method. In April 2005, the U.S. Securities and Exchange Commission adopted a rule that amended the effective dates of SFAS No. 123R. Under this rule, SFAS No. 123R is now effective for public companies at the beginning of the first fiscal year that begins after June 15, 2005. CME will adopt SFAS No. 123R effective January 1, 2006 and is currently evaluating the impact of adoption on the consolidated financial statements.

5. Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares of all classes of common stock outstanding for each reporting period. Diluted earnings per share reflects the increase in shares using the treasury stock method to reflect the impact of an equivalent number of shares of common stock if stock options were exercised and restricted stock awards were converted into common stock. Prior to the exercise of the remainder of the former CEO s option in the second quarter of 2004, the dilutive effect of that option was calculated as if the entire option, including the Class A share and Class B share portions of the option, was satisfied through the issuance of Class A shares. The diluted weighted average number of common shares outstanding at September 30, 2005 excludes the incremental effect related to 211,150 outstanding stock options that would be anti-dilutive.

	Nine Months Ended September 30,		Three Months Ended September 30,	
(in thousands, except per share data)	**2005**	**2004**	**2005**	**2004**
Net Income	$ 230,577	$ 162,771	$ 77,466	$ 59,428
Weighted Average Number of Common Shares:				
Basic	34,262	33,374	34,370	33,935
Effect of stock options	515	930	510	538
Effect of restricted stock grants	16	26	11	23
Diluted	34,793	34,330	34,891	34,496
Earnings per Share:				
Basic	$ 6.73	$ 4.88	$ 2.25	$ 1.75
Diluted	6.63	4.74	2.22	1.72

6. Subsequent Events

On October 14, 2005, CME renewed its existing secured committed line of credit with a consortium of banks. The renewed agreement is set to expire on October 13, 2006. The secured line of credit is for $750 million and is collateralized by clearing firm security deposits held by the exchange in the form of U.S. Treasury or agency securities, security deposit funds in IEF2 and performance bonds of the defaulting firm, if any. CME has the option to increase the facility from $750 million to $1 billion. The agreement does not require the participating banks to comply with the request for an increase. The line of credit can only be drawn on to the extent it is collateralized.

In October 2005, CME approved the use of up to $100 million in CME owned U.S. Treasury securities as performance bond collateral in connection with its mutual offset agreement with the Singapore Exchange Derivatives Trading Ltd. (SGX). Currently CME maintains all of its required performance bond collateral related to this agreement in the form of irrevocable letters of credit.

Also, in October 2005, CME Holdings amended its rights agreement, which creates rights that entitle CME Holdings shareholders to purchase shares of CME Holdings stock in the event that a third party initiates a transaction designed to take over the company. The amendment increased the purchase price of each one-thousandth of a share of Series A Junior Participating Preferred Stock pursuant to the exercise of a right from $105 to $1,000.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations for the Nine Months Ended September 30, 2005 Compared With the Nine Months Ended September 30, 2004

Overview

Our operations for the nine months ended September 30, 2005 resulted in net income of $230.6 million compared with net income of $162.8 million for the nine months ended September 30, 2004. The increase in net income resulted primarily from a $141.8 million increase in net revenues, partially offset by a $32.8 million increase in operating expenses. The increase in net revenues arose primarily because of a $105.9 million increase in clearing and transaction fees. In addition, we earned an incremental $12.2 million of revenue from clearing and transaction processing services and an incremental $12.1 million from investment income. Contributing to the $32.8 million overall increase in operating expenses was $11.9 million of additional compensation and benefits, an $8.6 million increase in depreciation and amortization, and smaller increases in most of our remaining expense categories.

Trading volume for the nine months ended September 30, 2005 totaled 788.5 million contracts, representing an increase of 34% over the same period in 2004 when total trading volume was 589.2 million. Contributing to increased trading volume levels were: improved speed and reliability created by CME Globex system enhancements; increased demand for electronically traded products; ongoing incentive programs designed to enhance liquidity and attract new customers, particularly in Europe and Asia; and increased demand for our interest rate, equity and foreign exchange products. The additional clearing and transaction fees resulting from greater trading volume and the increased percentage of electronic volume were augmented by increased fees for clearing and transaction processing services, additional investment income, and incremental revenue from quotation data fees.

Revenues

Clearing and Transaction Fees. Clearing and transaction fees, which include clearing fees, CME Globex electronic trading fees and other volume-related charges, increased $105.9 million, or 26%, to $519.7 million for the nine months ended September 30, 2005 from $413.8 million for the nine months ended September 30, 2004. The increase is attributed primarily to a 34% increase in average daily trading volume from 3.1 million contracts in 2004 to 4.2 million contracts in 2005. During the first nine months of 2005, average daily trading volume on CME Globex increased by 70% to 1.2 million contracts when compared with the same period in 2004. This increase was driven primarily by volume growth in interest rate, equity E-mini and foreign exchange products.

The following table summarizes average daily trading volume and revenue (volume in thousands). All amounts exclude TRAKRS unless otherwise noted.

	Nine Months Ended September 30,		Percentage Increase
	2005	2004	(Decrease)

CME Product Line			
Interest Rate	2,436	1,723	41%
Equity	1,366	1,169	17
Foreign Exchange	321	186	73
Commodity	49	40	23
Total Average Daily Volume	4,172	3,118	34
TRAKRS	26		