

CME Move Rekindles Exchange Consolidation Talk

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By Gaston F. Ceron and Mohammed Hadi

NEW YORK (Dow Jones)--News of a big futures merger Tuesday has revived the exchange-consolidation story.

The Chicago Mercantile Exchange Holdings Inc.'s (CME) agreement to acquire CBOT Holdings Inc. (BOT), parent of the Chicago Board of Trade, for \$8 billion in cash and stock would create a derivatives-trading powerhouse. It also sends a signal that exchanges remain keen to bulk up and could cause executives at other exchanges to rethink their options.

"The consolidation thesis is back on," said Jamie Selway, managing director at White Cap Trading in New York and a close follower of the exchange industry.

Shares of most exchanges rose in the wake of the CME-CBOT news even as the broader market fell. Energy marketplace IntercontinentalExchange Inc. (ICE) shot up 5.7%, and the options-focused International Securities Exchange Holdings Inc. (ISE) saw its shares gain 4.9%.

In recent years, the world's major financial exchanges have been shifting away from their provincial, private-club roots to become shareholder-owned businesses with ambitions to expand.

Active Year

This year has already been an active one for exchange dealmaking, with well over \$20 billion in announced major deals so far, according to Dealogic. For example, the NYSE Group Inc. (NYX), parent of the New York Stock Exchange, has struck a merger agreement with pan-European stock and derivative exchange Euronext NV (29064.AE). ICE last month agreed to buy the New York Board of Trade for \$1 billion. And Nasdaq Stock Market Inc. (NDAQ) has acquired a 25.3% stake in the London Stock Exchange PLC (LSE.LN).

"I get the sense that there's almost a mating frenzy going on here," said James Angel, associate professor of finance at Georgetown University and a former visiting academic at the National Association of Securities Dealers. "It's a time of massive restructuring in the business."

The activity has been a bonanza for shareholders. The Dow Jones Global Exchanges index, which measures the performance of 20 exchanges around the world, hit an

all-time high Tuesday and is up 55% on the year. That gain represents a \$43 billion increase this year in the market capitalization of the index's constituents.

While shares of other exchanges advanced Tuesday, NYSE shares edged lower, ending down 0.6% at \$73.48. Robert Webb, a former economist at the Commodity Futures Trading Commission who now studies markets as a University of Virginia professor, said the prospect of a CME-CBOT combination could make the NYSE's own derivatives play - through London-based Euronext.liffe - less powerful. A spokesman for the NYSE declined to respond.

The union of the two Chicago markets may provoke thinking about further deals. For example, Selway said this could lead Deutsche Boerse AG (DB1.XE), the German market that has continued to covet Euronext and that also had been mentioned as a possible partner for the CME, to re-examine its options.

"One wonders what Deutsche Boerse is thinking, if this gives them increased incentive in their quest for Euronext," Selway said. Deutsche Boerse declined to comment.

Opportunities For Savings

For exchanges, the appeal of mergers lies in the savings that can be reaped by combining assets such as technology and trading platforms while forming larger pools of trading that can attract more users across more product lines. The economic appeal for exchanges to grow bigger remains, suggesting that more mergers could develop.

"That's a powerful incentive no matter where you are in the globe, no matter what security you're trading," said **Michael Pagano**, associate professor of finance at Villanova University. "That cycle's not been exhausted."

According to CME data, the acquisition will create the world's largest futures exchange, with 84% more volume than Deutsche Boerse derivatives platform Eurex and more than triple the volume of Euronext.liffe, based on 2005 futures trading volume. The combined companies would boast a market value of \$25 billion, based on Monday's closing price for their shares, about 25% higher than a merged NYSE and Euronext, CME data showed.

The clout that the combined CME-CBOT will have in the U.S. will make it hard to beat, Pagano said, although internationally the picture is more competitive.

"Do you try to make an alliance with them or merge with them?" he said. "It's going to be hard to start from scratch."

More Targets

The deal could heighten interest in buying other U.S. exchanges that deal in derivatives. The ICE and the ISE are "the most interesting takeover targets," said Bear Stearns analyst Daniel Goldberg, in a research note. The ICE "could be interesting for Deutsche Boerse."

The New York Mercantile Exchange (NYM.XX), which has a partnership with the CME and just approved an initial public offering of stock, also is seen as a possible takeover candidate. The Nymex declined to comment on merger speculation.

Growing options activity - the volume of options contracts traded in the first nine months of 2006 rose 39.4% from the same period in 2005, according to the Options Industry Council - makes the ISE "a prime candidate for consolidation," Goldberg said.

The ISE and ICE declined to comment on merger speculation. Goldberg doesn't own ISE or ICE shares, but Bear Stearns has done investment-banking work for the ISE.

Among options markets, the Chicago Board Options Exchange also is seen as a prize. The CBOE recently revealed that it held merger talks with the CBOT, although those discussions fell apart.

The CBOE is now in the midst of a conversion from a member-owned exchange to a shareholder-owned company. Such a move is widely expected to pave the way to an initial public offering or even a merger. The conversion hit a roadblock in August, however, when the CBOT filed a lawsuit asserting that its members, who hold rights to trade on the CBOE, also have claims on its equity.

The price seats on the CBOE jumped Tuesday, as buyers appeared to speculate that the CME-CBOT merger would break the logjam of the trading rights issue. The price of these seats rose to \$1.5 million Tuesday, from \$1.4 million on Monday. That's a new record and also 71% higher than the highest price paid in 2005.

The CBOE didn't have a comment on how the deal would affect the trading rights issue.

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