HDFC securities

INSTITUTIONAL RESEARCH

COMPANY UPDATE | 2 MAR 2015

Multi Commodity Exchange

BUY

INDUSTRY	**EXCHANGES**
CMP *(as on 28 Feb 2015)*	**Rs 1,190**
Target Price	**Rs 1,530**
Nifty	8,902
Sensex	29,362
KEY STOCK DATA	
Bloomberg	MCX IN
No. of Shares (mn)	51
MCap (Rs bn) / ($ mn)	61/981
6m avg traded value (Rs mn)	664
STOCK PERFORMANCE (%)	
52 Week high / low	**Rs 1,210/425**

	3M	6M	12M
Absolute (%)	37.2	40.9	126.2
Relative (%)	33.9	32.2	87.2

SHAREHOLDING PATTERN (%)	
Promoters	-
FIs & Local MFs	35.99
FIIs	20.29
Public & Others	43.72

Source : BSE

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Unleashing the tiger

In Budget 2015-16, the Finance Minister announced the merger of the Securities Exchange Board of India (SEBI) and the Forward Markets Commission (FMC). As highlighted earlier (click here & here), this move clearly shows that that the government intends to develop the commodity derivatives market in keeping with global standards.

The SEBI-FMC merger will result in a strong regulator for the commodities derivatives business as the government intends to curb speculation in commodities trading. As commodity exchanges will now be regulated by SEBI, MCX will be able to (1) launch new products such as options, indices, weather/currency/interest rate derivates (2) see participation from financial institutions (FI) and foreign portfolio investors (FPIs/FIIs). An empowered regulator will also be able to crack down on Dabba trading (bucket shops), further boosting exchange volumes.

We increase our FY17 estimates factoring in benefits from (1) launch of options/indices (2) increased volumes due to new participants in the exchange. We maintain our high-conviction positive stance on the company on account of (1) significant business operating leverage (2) potential for non-linear growth driven by conducive policy framework. Considering the regulatory tailwinds and high growth potential, we now value MCX at 26x FY17E EPS (earlier 25x FY17E EPS) arriving at a target price of Rs 1,530.

- **New products and participants to drive exchange volumes:** MCX is prepared with options and indices and can launch products as soon as the SEBI issues appropriate guidelines. Our FY17E ADTV estimates now factor in the upside from launch of options.
- **Other positives as well:** Currently, investment limits in MCX's equity are 23% and 26% each for FPI and foreign direct investments (FDI). FPI in MCX stood at 20.5% (Q3FY15), against a limit of 23%, indicating very limited headroom for incremental FPI investment, while the FDI limit is unutilized. The merger of FDI and FPI limits gives adequate headroom for FPI's to invest in MCX's equity.

  Tax exemption of income earned on the settlement guarantee fund is another marginal positive for the company.
- **Key risks:** (1) MCX continues to rely on the software platform of Financial Technologies India Limited. FTIL could slip on support if there is any adverse outcome of judicial probes that it faces (2) Competition: now equity exchanges will also be able to launch commodity derivative products (3) regulatory risks

FINANCIAL SUMMARY

(Rs mn)	FY13	FY14	FY15E	FY16E	FY17E
Net Sales	4,992	3,197	2,144	3,231	4,951
EBITDA	3,152	1,457	825	1,761	3,251
PAT	2,986	1,528	1,119	1,863	3,001
EPS (Rs)	58.9	30.2	21.9	36.5	58.8
P/E (x)	17.7	34.4	54.1	32.5	20.2
P/BV (x)	4.6	4.6	6.2	5.7	4.9
RoE (%)	27.8	13.3	10.5	18.3	26.2

Source : Company, HDFC sec Inst Research

Valuation

- We expect MCX to show a robust 64% FY15-17 earnings CAGR driven by revenue growth of 52% CAGR during the same period. MCX currently trades at 33x FY16 and 20x FY17 EPS. **We believe that MCX can command premium multiples as operating performance is boosted by regulatory tailwinds. Thus we assign a target multiple of 26x FY17 EPS arriving at a target price of Rs 1,530.** The company also has 5% stake (and warrants convertible in Jun-15 resulting in 32% stake) in MCX-SX (MCX Stock Exchange), ~3% stake in Dubai Gold and Commodities Exchange (DGCX), 51% stake in SME Exchange of India Limited and 100% stake MCXCCL(Multi Commodity Exchange Clearing Corporation Limited). **Owing to business continuity challenges, we aren't attributing any value to these investments.**

Premium valuation to sustain

- *MCX will continue to trade at premium valuations (33x FY16E EPS – 65% premium to global peers), on account of the company's robust growth trajectory.*
- *We expect MCX's EPS to grow at 64% CAGR from FY15-17, versus 12%, which is the average EPS growth of listed peers*
- *MCX trades at a PEG of 0.3, comparing favourably to global exchanges, which trade at a PEG of 1.7*

VALUATION : GLOBAL EXCHANGES

	Country	M-Cap (US$ mn)	Forward P/E (x)		EPS growth (2-yr CAGR)	PEG (x)	Forward P/B (x)		EV/EBITDA (x)		ROE (%)	
			1-yr fwd	2-yr fwd			1-yr fwd	2-yr fwd	1-yr fwd	2-yr fwd	1-yr fwd	2-yr fwd
Emerging markets												
MCX (HDFC Sec estimates)	India	984	32.5	20.2	63.7	0.32	5.7	4.9	27.7	14.6	18.3	26.2
Bloomberg Consensus estimates												
BM&FBovespa SA	Brazil	6,385	11.2	9.7	14.9	0.65	1.0	0.9	10.4	9.2	8.2	10.4
Bursa Malaysia Bhd	Malaysia	1,224	20.2	18.6	8.2	2.26	5.9	5.7	11.0	10.1	28.4	31.0
Bolsa Mexicana	Mexico	1,070	17.9	16.2	11.3	1.44	3.0	2.8	10.9	9.9	15.7	17.9
Multi Commodity Exchange	India	984	38.3	32.0	25.1	1.27	5.3	4.6	19.5	16.7	12.4	14.2
EM average			**21.9**	**19.1**	**14.9**	**1.41**	**3.8**	**3.5**	**13.0**	**11.5**	**16.2**	**18.4**
Developed markets												
CME Group	USA	33,535	22.7	20.8	20.8	1.6	1.6	13.6	12.4	6.4	6.4	33,535
Hong Kong Exchanges	Hong Kong	26,381	26.3	23.5	13.1	9.6	8.8	0.2	0.2	34.4	36.3	26,381
Intercontinental Exchange	USA	25,859	16.6	15.3	8.4	2.1	1.8	11.4	10.0	10.7	10.4	25,859
Deutsche Boerse	Germany	15,322	17.7	15.8	10.9	4.3	3.3	12.1	10.8	20.2	20.2	15,322
London Stock Exchange	UK	12,844	17.8	15.1	17.4	347.1	313.4	9.9	9.2	18.3	19.2	12,844
Nasdaq OMX	USA	8,509	13.9	13.2	6.6	1.5	1.4	8.9	8.3	9.8	10.1	8,509
Japan Exchange Group	Japan	7,935	25.6	24.3	10.5	4.5	4.0	13.9	13.3	15.7	15.0	7,935
Singapore Exchange	Singapore	5,831	20.8	18.2	14.1	9.7	7.9	14.6	12.8	39.1	41.4	5,831
ASX	Australia	6,333	19.9	18.8	5.2	2.2	2.2	13.0	12.4	11.0	11.4	6,333
CBOE Holdings	USA	5,014	22.7	20.8	10.3	20.1	16.2	11.8	10.9	76.7	79.6	5,014
Hellenic Exchanges	Greece	342	11.7	10.1	17.4	1.7	1.6	4.2	3.6	13.8	17.3	342
NZX Ltd	New Zealand	211	16.2	14.3	8.8	5.6	6.4	9.3	8.4	31.2	33.9	211
Developed markets average			**19.3**	**17.5**	**11.9**	**34.2**	**30.7**	**10.2**	**9.4**	**23.9**	**25.1**	
Global average			**19.8**	**17.6**	**13.2**	**26.6**	**23.9**	**11.1**	**9.9**	**22.0**	**23.5**	

Source: Bloomberg, HDFC sec Inst Research Note: 1-yr refers to FY16/CY15 & 2-yr FY17/CY16

Change in estimates

- *We expect MCX's ADTV to improve ~40% in FY16 led by new product launches and a reinvigorated business focus driven by the company's new MD & CEO. Our transaction charges are now reflective of trends observed in 9MFY15 (Rs 18.7/mn).*
- *Our FY17 estimates factor in (1) launch of options (2) increase in volumes due to greater participation (FIs/FPIs). We assume FY17 ADTV at 100% of the FY12 peak*
- *We now value the company at 26x FY17E EPS (earlier 25x FY17E EPS) on account of regulatory tailwinds and improving operational performance.*

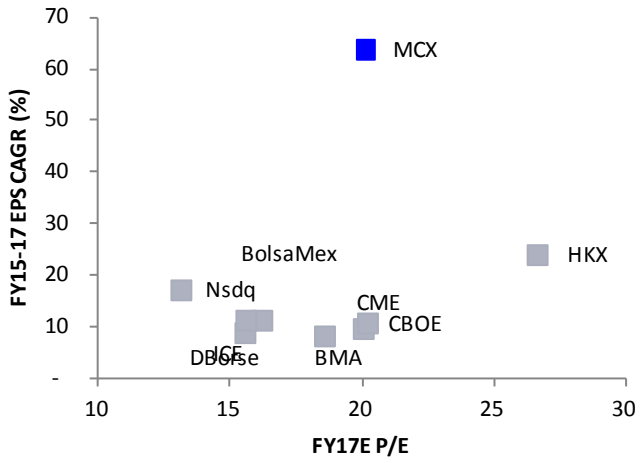
MCX – Change in estimates

Amounts in Rs mn, unless otherwise mentioned	Earlier			New			Increase (decrease) %		
	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E
ADT V (Rs mn)	210	322	428	210	322	503	-	-	18
Transaction charges (Rs/mn)	18.1	18.1	18.1	18.7	18.7	18.7	3	3	3
Revenue	2,287	3,376	4,410	2,352	3,476	5,248	3	3	19
EBITDA	726	1,627	2,452	825	1,761	3,251	14	8	33
PAT	1,167	1,755	2,403	1,119	1,863	3,001	(4)	6	25
EPS (Rs)	22.9	34.4	47.1	21.9	36.5	58.8	(4)	6	25

MCX – Sensitivity of target price to ADTV assumptions

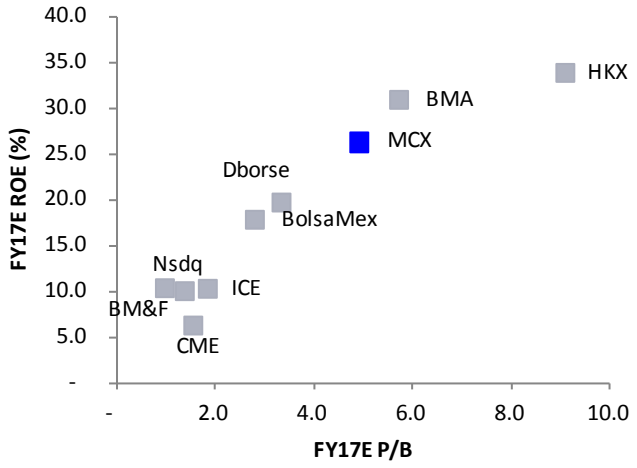
Target price (Rs)		FY17e PE (x)					FY17e ADTV (Rs bn)
		20.0	23.0	**26.0**	28.0	30.0	
FY17e ADTV (% of FY12 peak)	85%	993	1,142	**1,291**	1,390	1,490	428
	90%	1,054	1,212	**1,371**	1,476	1,581	453
	100%	**1,177**	**1,353**	**1,530**	**1,647**	**1,765**	**503**
	110%	1,299	1,494	**1,689**	1,819	1,949	553
	120%	1,422	1,635	**1,848**	1,990	2,132	604

PE (FY17E) versus EPS CAGR (FY15-17/CY14-16)



Source: Company, Industry, HDFC sec Inst Research

ROE versus Price to book ratio



Source: Company, Industry, HDFC sec Inst Research

Abbreviations represent: BMA - Bursa Malaysia Bhd, BolsaMex - Bolsa Mexicana, CME – Chicago Mercantile Exchange Group, HKX - Hong Kong Exchanges, ICE - Intercontinental Exchange, Dborse - Deutsche Boerse, Nsdq - Nasdaq OMX, CBOE – Chicago Board Options Exchange

INCOME STATEMENT (Standalone)

(Rs mn)	FY13	FY14	FY15E	FY16E	FY17E
Net Sales	**4,992**	**3,197**	**2,144**	**3,231**	**4,951**
Growth (%)	***(5.1)***	***(35.9)***	***(32.9)***	***50.7***	***53.2***
Software support charges	782	622	396	466	641
Employee Expenses	289	313	362	412	464
SG&A Expenses	206	200	200	220	242
Other Operating Expenses	810	814	568	617	650
Operating Profits	**2,904**	**1,248**	**618**	**1,515**	**2,954**
Operating Profit Margin (%)	***58.2***	***39.0***	***28.8***	***46.9***	***59.7***
Other Operating Income	248	209	208	245	297
EBITDA	**3,152**	**1,457**	**825**	**1,761**	**3,251**
EBITDA (%)	***60.2***	***42.8***	***35.1***	***50.7***	***62.0***
EBITDA Growth (%)	***(10.3)***	***(53.8)***	***(43.4)***	***113.3***	***84.7***
Other Income	1,207	993	956	1,000	1,085
Depreciation	307	343	273	277	282
EBIT	**4,052**	**2,107**	**1,507**	**2,484**	**4,055**
Interest	0	11	15	-	-
PBT	4,051	2,096	1,492	2,484	4,055
Tax	1,065	569	373	621	1,054
PAT	**2,986**	**1,528**	**1,119**	**1,863**	**3,001**
EO items (net of tax)	-	-	-	-	-
APAT	**2,986**	**1,528**	**1,119**	**1,863**	**3,001**
APAT Growth (%)	***(0.6)***	***(48.8)***	***(26.7)***	***66.4***	***61.1***

Source: Company, HDFC sec Inst Research

BALANCE SHEET (Standalone)

(Rs mn)	FY13	FY14	FY15E	FY16E	FY17E
SOURCES OF FUNDS					
Share Capital - Equity	510	510	510	510	510
Reserves	11,036	10,931	9,270	10,107	11,777
Total shareholders' Funds	**11,546**	**11,441**	**9,780**	**10,617**	**12,287**
Settlement guarantee fund	21	1,720	2,620	2,751	2,889
Total Debt	-	-	-	-	-
Deferred Taxes	196	152	152	152	152
Long Term Provisions & Others	373	298	298	298	298
TOTAL SOURCES OF FUNDS	**12,136**	**13,610**	**12,850**	**13,817**	**15,625**
APPLICATION OF FUNDS					
Net Block	2,044	1,735	1,662	1,634	1,653
Long-term investments	1,481	132	132	132	132
Other long-term assets	531	1,564	281	281	281
Cash & Equivalents	12,677	12,900	12,568	14,245	17,067
ST Loans & Advances, Others	1,125	1,084	773	1,048	1,582
Total Current Assets	13,802	13,984	13,341	15,293	18,649
Trading margin from members	4,324	2,585	1,672	2,559	3,998
Other Current Liabilities & Provns	1,398	1,221	894	964	1,092
Total Current Liabilities	**5,721**	**3,805**	**2,566**	**3,523**	**5,090**
Net Current Assets	**8,080**	**10,179**	**10,775**	**11,770**	**13,559**
TOTAL APPLICATION OF FUNDS	**12,136**	**13,610**	**12,850**	**13,817**	**15,625**

Source: Company, HDFC sec Inst Research

CASH FLOW (Standalone)

(Rs mn)	FY13	FY14	FY15E	FY16E	FY17E
Reported PAT	**2,986**	**1,528**	**1,119**	**1,863**	**3,001**
Non-operating & EO items	(1,114)	(779)	(956)	(1,000)	(1,085)
PAT from Operations	**1,872**	**748**	**164**	**862**	**1,916**
Interest expenses	0	11	15	-	-
Depreciation	307	343	273	277	282
Working Capital Change	(3,523)	(1,465)	(928)	683	1,033
OPERATING CASH FLOW (a)	**529**	**385**	**(476)**	**1,823**	**3,230**
Capex	(462)	(59)	(200)	(250)	(300)
Free cash flow (FCF)	*68*	*326*	*(676)*	*1,573*	*2,930*
Investments	1,333	67	-	-	-
INVESTING CASH FLOW (b)	**872**	**8**	**(200)**	**(250)**	**(300)**
Debt Issuance	-	-	-	-	-
Interest expenses	(0)	(0)	(15)	-	-
FCFE	*1,401*	*393*	*(691)*	*1,573*	*2,930*
Share capital Issuance	-	-	-	-	-
Dividend	(2,134)	(1,133)	(597)	(895)	(1,193)
FINANCING CASH FLOW (c)	**(2,134)**	**(1,133)**	**(597)**	**(895)**	**(1,193)**
NET CASH FLOW (a+b+c)	**(733)**	**(740)**	**(1,273)**	**678**	**1,737**
Non-operating and EO items	576	519	941	1,000	1,085
Closing Cash & Equivalents	12,677	12,900	12,568	14,245	17,067

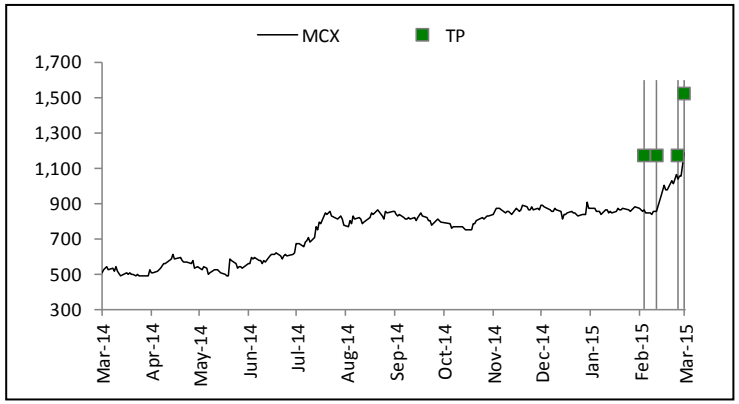
Source: Company, HDFC sec Inst Research

KEY RATIOS (Standalone)

	FY13	FY14	FY15E	FY16E	FY17E
PROFITABILITY (%)					
GPM	85.1	81.8	83.1	86.6	87.8
EBITDA Margin	60.2	42.8	35.1	50.7	62.0
APAT Margin	57.0	44.8	47.6	53.6	57.2
RoE	27.8	13.3	10.5	18.3	26.2
RoIC or Core RoCE	31.9	20.8	24.5	32.9	39.2
RoCE	16.7	8.8	7.3	10.7	14.5
EFFICIENCY					
Tax Rate (%)	25.2	29.3	25.0	25.0	26.0
Asset Turnover (x)	0.3	0.2	0.2	0.2	0.3
Debtors (days)	78	116	120	110	110
Payables (days)	284	272	280	270	260
Cash Conversion Cycle (days)	(205)	(156)	(160)	(160)	(150)
Debt/EBITDA (x)	(2.7)	(7.1)	(13.2)	(6.6)	(4.0)
Net D/E	(0.7)	(0.9)	(1.1)	(1.1)	(1.1)
Interest Coverage	13,069	198	NM	NM	NM
PER SHARE DATA					
EPS (Rs/sh)	58.9	30.2	21.9	36.5	58.8
CEPS (Rs/sh)	64.9	36.9	27.3	42.0	64.4
DPS (Rs/sh)	24.0	10.0	10.0	15.0	20.0
BV (Rs/sh)	226.4	224.3	191.8	208.2	240.9
VALUATION					
P/E	20.2	39.3	54.1	32.5	20.2
P/BV	5.2	5.3	6.2	5.7	4.9
EV/EBITDA	16.6	34.5	60.1	27.7	14.6
OCF/EV (%)	1.01	0.77	(0.96)	3.73	6.80
FCF/EV (%)	0.13	0.65	(1.36)	3.22	6.17
FCFE/mkt cap (%)	0.23	0.06	(0.11)	0.26	0.48
Dividend Yield (%)	2.02	0.84	0.84	1.26	1.68

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
5-Feb-15	859	BUY	1,180
16-Feb-15	860	BUY	1,180
27-Feb-15	1,039	BUY	1,180
2-Mar-15	1,190	BUY	1,530

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

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