4 May 2017

Results Update | Sector: Others

MCX

BSE SENSEX	S&P CNX
30,126	9,360
Bloomberg	MCX IN
Equity Shares (m)	51
M.Cap.(INRb)/(USDb)	58.8 / 0.9
52-Week Range (INR)	1420 / 852
1, 6, 12 Rel. Per (%)	-4/-24/10
Avg Val, INRm	483
Free float (%)	100.0

Financials & Valuations (INR b)

Y/E Mar	2017	2018E	2019E
Net Sales	2.4	2.7	3.5
EBITDA	0.6	0.8	1.5
PAT	1.3	1.6	2.2
EPS (INR)	24.8	30.5	42.9
Gr. (%)	6.2	23.1	40.3
BV/Sh (INR)	266.4	282.0	303.8
RoE (%)	9.9	11.1	14.6
RoCE (%)	9.6	10.8	14.2
P/E (x)	46.5	37.7	26.9
P/BV (x)	4.3	4.1	3.8

Estimate change ⟷

TP change ⟷

Rating change ⟷

CMP: INR1,153 TP: INR1,325(+15%) Buy

Higher operating expenses compound bullion volumes decline

Expect trading in options to commence in 2-3 months

- **Revenue hurt by tepid volumes:** 4QFY17 revenue from operations grew 3.2% YoY to INR574m (in-line). Volumes fell 16.5% YoY, led mainly by bullion (gold down by 51% and silver by 26%) in the aftermath of demonetization. Average daily turnover in 4Q was INR199b. However, average realization rose ~18% YoY after pricing hike taken by MCX (effective 1 October 2016).
- **Profit miss on higher operating expenses:** EBITDA of INR79m missed estimate of INR128m due to other expenses of INR225m (+41% YoY; est. of INR160m) toward regulatory fees/investments in GIFT city. Full-year other expenses were INR690m, which MCX expects to maintain next year too. PAT fell 19% YoY to INR219m (est. of INR296m) on lower operating profit.
- **GST – added concern for near-term bullion volumes:** After suffering in 3QFY17 post demonetization due to slow activity in the underlying physical commodity business, volumes failed to pick up in 4Q. Management cited continued tepid activity in the physical markets – this time compounded by GST-related uncertainty. That said, MCX expects volumes to recover, and options to commence in next 2-3 months. This may be followed by the entry of competition in the segment (likely by end-FY18 or beginning of next fiscal) following the grant of 'universal exchange' license.
- **Volumes recovery not too far:** We have retained our volume ramp-up estimates for MCX, and factor in commencement of options from 2QFY18 – building ~6% volumes from the same this year, growing gradually thereon. This should kick-start volumes recovery, which should continue with the entry of new participants such as FIs and new products such as indices. This drives our expectation of healthier revenue growth in FY19 (31%) and consequently driving earnings growth (~40%). Our price target of INR1,325 discounts FY19E earnings by 30x, implying 15% upside. Maintain **Buy**.

Quarterly Performance (Consolidated)

	FY16				FY17				FY16	FY17	Est.	Var.
	1Q	2Q	3Q	4Q	1Q	1Q	3Q	4Q			4Q	(%/bp)
Sales	**518**	**563**	**498**	**556**	**582**	**596**	**634**	**574**	2,135	2,386	574	(0.1)
Q-o-Q Gr. (%)	-1.8	8.8	-11.6	11.6	16.9	7.1	6.5	-9.5	4.8	11.7	-9.5	-5bp
Staff Costs	90	109	100	106	143	144	198	160	406	644	163	(1.9)
Other expenses	282	318	264	313	265	257	296	335	986	1,116	284	18.2
Depreciation	63	65	64	54	49	42	45	49	246	186	45	9.0
EBIT	**83**	**71**	**70**	**82**	**125**	**152**	**96**	**30**	**498**	**440**	83	(63.8)
Margins (%)	16.1	12.7	14.0	14.8	21.5	25.6	15.1	5.2	23.3	18.4	14.4	-921bp
Other Income	300	338	276	278	356	359	363	295	1,191	1,373	313	(5.6)
PBT bef. Exceptional items	**382**	**409**	**346**	**360**	**480**	**511**	**459**	**325**	**1,689**	**1,811**	**395**	**(17.8)**
Tax	131	99	110	72	152	134	119	106	413	512	99	7.1
Rate (%)	34.3	24.2	31.8	20.1	31.7	26.3	26.0	32.6	24.4	28.3	25.0	757bp
PAT	**251**	**310**	**236**	**287**	**328**	**376**	**339**	**219**	**1,277**	**1,299**	296	(26.1)
Q-o-Q Gr. (%)	-49.0	23.5	-24.0	21.8	14.1	14.8	-9.9	-35.5	2.1	210.6	-12.8	
EPS (INR)	**4.9**	**6.1**	**3.5**	**5.3**	**6.5**	**7.4**	**6.7**	**4.3**	**25.0**	**25.5**	**5.8**	**(26.1)**
Total volumes (INR t)	**13.6**	**14.8**	**13.0**	**14.9**	**16.0**	**16.4**	**13.9**	**12.4**	**56.3**	**58.7**	**12.4**	
Q-o-Q Gr. (%)	-3.5	9.2	-12.0	14.3	7.3	2.3	-15.2	-10.3			-10.3	
Y-o-Y Gr. (%)	15.4	18.5	-3.3	5.9	17.7	10.3	6.4	-16.5	8.7	4.1	-16.5	

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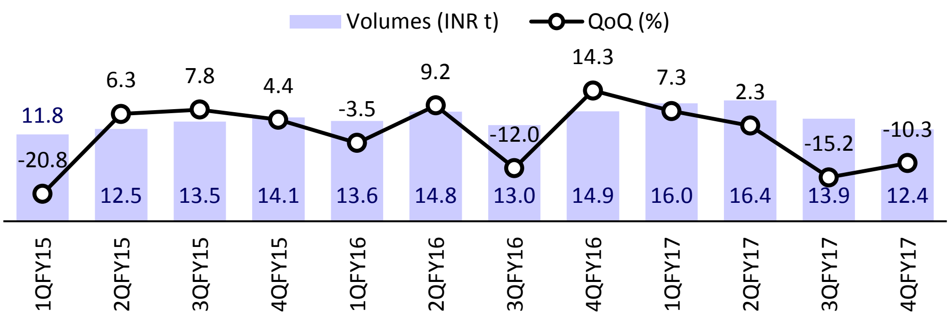
Takeaways from management commentary

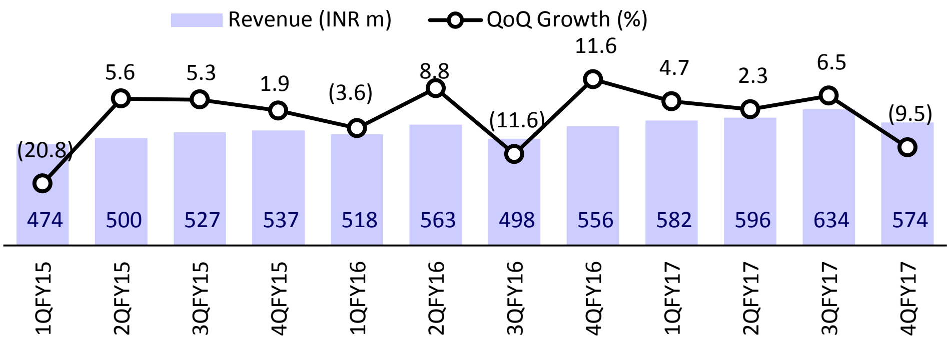
- **Bullion led decline:** Total income in 4Q saw a decline of 19% YoY. The decline in revenue was led by challenges resulting out of demonetization. This had a direct impact on volumes in the bullion market. The performance in base metals, energy and agri commodities has not been impacted because of this. Lower treasury income was led by a drop in yields.
- **Introduction of options:** SEBI has been rapidly taking action lately. The approval for options came through and execution can be expected over the next two-three months. This does not need to be taken up by the parliament for further approvals.
- **Other developments on the block as well:** MCX has started working with Thomson Reuters on the development of index products. Although nothing has been announced by SEBI on this front, MCX has already started preparing for future introduction. The order of developments is expected to be [1] Options, [2] Index and [3] Complex derivatives.
- **Expenses for FY17:** MCX consciously reduced its advertising expense to INR36m in FY17. For the next year, this line item should be an average of what was incurred in FY16 and FY17. Additionally there was an increase of 10% in operating expenses, led by higher regulatory fees, investments in GIFT city and technology expenses. In absolute terms, operating expenses are expected to remain steady in the next year.

Exhibit 1: Volumes during the quarter remained weak



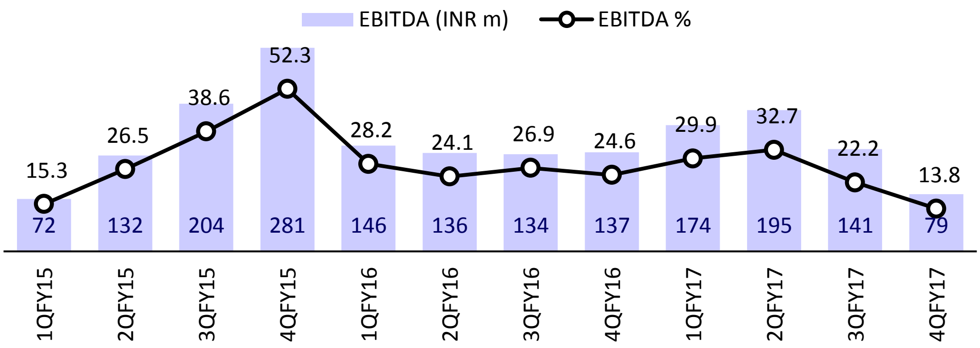
Source: Company, MOSL

Exhibit 2: Revenue in 2H range bound as pricing increase offset volume decline



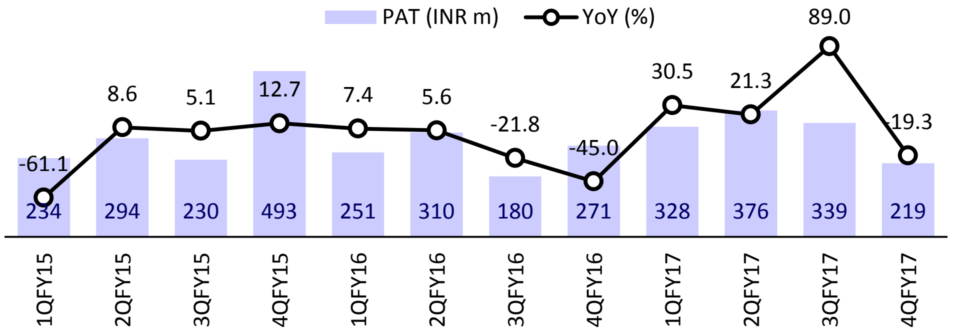
Source: Company, MOSL

Exhibit 3: Higher other expenses led to profitability pressure…



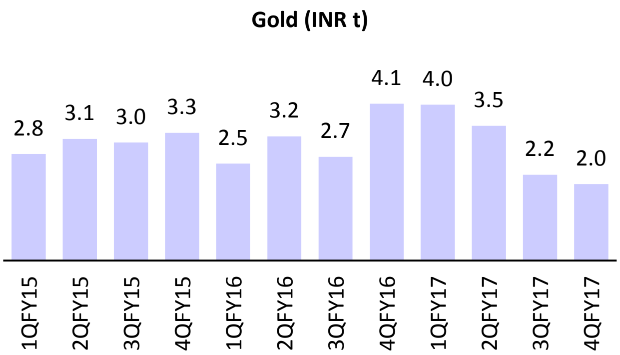
Source: Company, MOSL

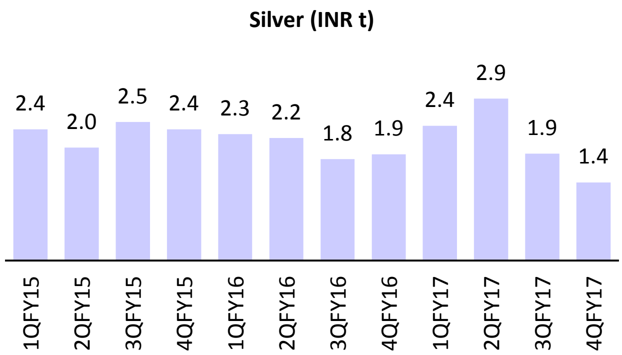
Exhibit 4: …Which consequently seeped through PAT



Source: Company, MOSL

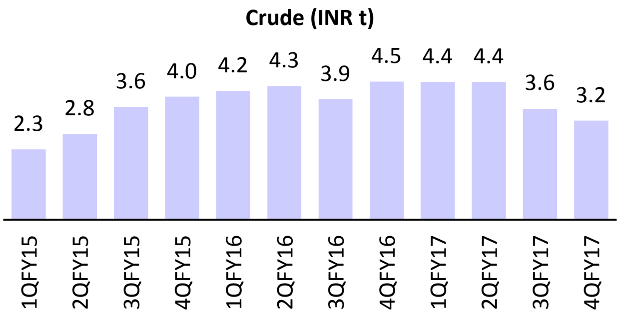
Exhibit 5: Bullion volumes severely impacted

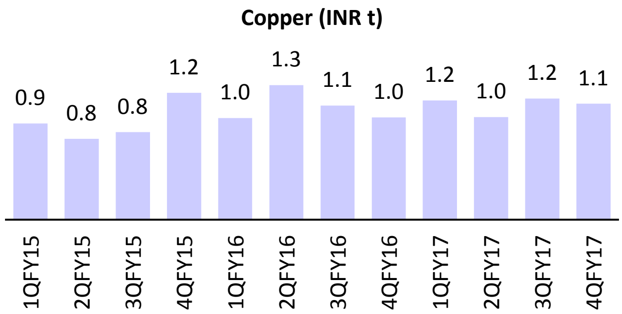




Source: Company, MOSL

Exhibit 6: Crude volumes declined by 28% YoY, while Copper increased by 13% YoY





Source: Company, MOSL

Valuation and view

- **Market leadership in winner-takes-all business:** MCX has retained its market leadership position, with a share of 80-90% over FY09-16. Even in the most turbulent of months during FY13-14, when the parent's existence was in deep waters on issues of fraud around National Spot Exchange (NSEL), the exchange managed to retain its share. Additionally, it has remained without a fulltime MD & CEO since May 2014 when Mr Manoj Vaish resigned after just three months. This is a reflection of the winner-takes-all nature of the business model.
- **Monopoly share in multiple commodities takes care of concentration risk:** MCX's golden run in terms of volumes came at the time of significant run-up in gold and silver prices in FY12 and FY13. That was also perceived to be a risk, given that the share of volumes from these two commodities had exceeded 70%. However, presence in multiple commodities helps avert the concentration risk, and this was evidenced in FY15, when action in oil prices drove energy to exceed gold as the largest traded commodity at MCX by value.
- **All eyes on reforms, as SEBI-FMC merger is complete:** SEBI's merger with FMC is now complete, paving the way for much awaited reforms in the ecosystem. The upside for MCX may yet be partly a function of reports around approvals to competition and entry of a credible global exchange materializing. We don't expect these at one-go or immediately, but rather in a gradual, phased manner over the course of the next calendar year. SEBI already has the ball rolling in terms of reform and expects universal licenses to be active through the course of the year. MCX could, in the meanwhile: [1] get a head start, and [2] strengthen itself with investment from CME.
- **Volume reversal to pre-CTT levels is our base case:** Our base case assumes gradual recovery in volumes to INR350b-400b in FY19E, closer towards pre-commodities transaction tax (CTT) average daily turnover of INR450b-500b. This compares with current ADT of INR200b-250b.
- **Volumes have taken a temporary hit:** Volumes suffered in 2HFY17 on account of demonetization's impact on gold volumes. Post this, a failure in pick-up has resulted out of tepid activity in the physical market. This time, it is compounded by uncertainty posed by GST. That said, MCX expects volumes to recover going forward, and Options to commence in the next 2-3 months.
- **Multiplier effect on operational earnings from operating leverage, Buy:** From 2QFY18, Options will also be launched, a key trigger for volumes. This should kick start the recovery in volumes, that should continue with the entry of new participants such as FIs and new products such as indices. This drivers our expectation of healthier revenue growth in FY19 (31%) and consequently driving earnings growth (~40%). Our price target of INR1,325 discounts FY19E earnings by 30x, implying 15% upside. **Buy**.

Key triggers

- Pick-up in volume led by the introduction of new products like Options / Indices
- Introduction of new participants like Banks / FIs
- High volatility in key commodities like Bullion / Crude

Key risk – increased competition from equity exchanges

One of the implications of FMC's merger with SEBI is that stock exchanges will be able to become universal exchanges, where equities, debt instruments and currencies are traded under the same roof as commodity derivatives. Stock exchanges already have depositories and clearing corporations that will cater to the needs of commodity traders as well. If NSE enters the commodities segment, MCX could see stiff competition, which may impair both market share and profit margins

Financials and Valuations

Income Statement (INR Million)

Y/E Mar	2012	2013	2014	2015	2016	2017	2018E	2019E
Net Sales	**5,262**	**4,992**	**3,197**	**2,038**	**2,135**	**2,386**	**2,678**	**3,514**
Change (%)	42.6	-5.1	-35.9	-36.3	4.8	11.7	12.3	31.2
EBITDA	**3,347**	**2,932**	**1,248**	**689**	**553**	**589**	**782**	**1,512**
EBITDA Margin (%)	63.6	58.7	39.0	33.8	25.9	24.7	29.2	43.0
Depreciation	272	307	343	259	246	186	215	214
EBIT	**3,075**	**2,625**	**905**	**430**	**307**	**403**	**567**	**1,298**
Interest	0	0	11	14	0	2	2	2
Other Income	1,027	1,427	1,202	1,285	1,191	1,373	1,512	1,618
Extraordinary items	-142	0	0	0	-667	0	0	0
PBT	**3,960**	**4,051**	**2,097**	**1,701**	**831**	**1,774**	**2,077**	**2,915**
Tax	1,098	1,065	569	450	413	512	519	729
Tax Rate (%)	27.7	26.3	27.1	26.5	49.7	28.8	25.0	25.0
Min. Int. & Assoc. Share	0	0	0	0	0	0	0	0
Reported PAT	**2,862**	**2,986**	**1,528**	**1,251**	**418**	**1,263**	**1,558**	**2,186**
Adjusted PAT	**2,862**	**2,986**	**1,528**	**1,251**	**418**	**1,263**	**1,558**	**2,186**
Change (%)	65.6	4.4	-48.8	-18.1	-66.6	201.9	23.4	40.3

Balance Sheet (INR Million)

Y/E Mar	2012	2013	2014	2015	2016	2017	2018E	2019E
Share Capital	508	510	510	510	510	510	510	510
Reserves	9,461	11,058	10,931	11,512	11,529	13,078	13,870	14,982
Net Worth	**9,969**	**11,567**	**11,441**	**12,022**	**12,039**	**13,588**	**14,380**	**15,492**
Debt	432	569	2,169	2,214	2,162	2,125	2,125	2,125
SGF	0	0	1,720	1,871	1,879	1,705	1,705	1,705
Total Capital Employed	**10,401**	**12,136**	**13,610**	**14,236**	**14,201**	**15,713**	**16,505**	**17,617**
Net Fixed Assets	**1,369**	**2,044**	**1,735**	**1,552**	**3,528**	**5,905**	**5,932**	**5,985**
Capital WIP	1	0	0	0	0	0	0	0
Investments	11,502	10,682	10,898	12,927	8,643	7,676	7,676	7,676
Current Assets	**5,887**	**5,131**	**4,782**	**3,764**	**5,997**	**5,077**	**7,430**	**8,617**
Debtors	514	69	90	107	42	28	81	104
Cash & Bank	3,124	3,475	3,417	2,655	5,003	3,890	5,932	6,777
Loans & Adv, Others	2,249	1,587	1,275	1,002	952	1,159	1,417	1,736
Curr Liabs & Provns	**8,358**	**5,721**	**3,805**	**4,007**	**3,967**	**2,945**	**4,533**	**4,660**
Net Current Assets	**-2,471**	**-590**	**977**	**-243**	**2,030**	**2,132**	**2,897**	**3,957**
Total Assets	**10,401**	**12,136**	**13,610**	**14,236**	**14,201**	**15,713**	**16,505**	**17,617**

Financials and Valuations

Ratios

Y/E Mar	2012	2013	2014	2015	2016	2017	2018E	2019E
Basic (INR)								
EPS	**56.1**	**58.6**	**30.0**	**24.6**	**23.4**	**24.8**	**30.5**	**42.9**
Cash EPS	61.4	64.6	36.9	29.6	13.0	28.4	34.8	47.1
Book Value	195.5	226.8	225.4	235.8	236.1	266.4	282.0	303.8
DPS	24.0	0.5	10.2	10.2	0.0	15.3	20.4	20.4
Payout (incl. Div. Tax.)	50.0	0.9	39.0	48.5	0.0	73.3	79.2	56.4
Valuation(x)								
P/E				46.9	49.4	46.5	37.7	26.9
Cash P/E				38.9	88.5	40.6	33.2	24.5
Price / Book Value				63.2	82.4	81.0	58.4	29.6
EV/Sales				21.4	21.3	20.0	17.0	12.8
EV/EBITDA				4.9	4.9	4.3	4.1	3.8
Dividend Yield (%)				1.0	-	1.6	2.1	2.1
Profitability Ratios (%)								
RoE	31.0	27.7	13.3	10.7	3.5	9.9	11.1	14.6
RoCE	24.8	26.5	12.8	10.4	8.8	9.6	10.8	14.2
RoIC	0	0	0	0	0	0	0	0
Turnover Ratios (%)								
Fixed Asset Turnover (x)	31.2	27.3	18.1	11.4	11.7	13.0	13.5	16.2
Debtors (No. of Days)	36	5	10	19	7	4	11	11
Leverage Ratios (%)								
Net Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Cash Flow Statement (INR Million)

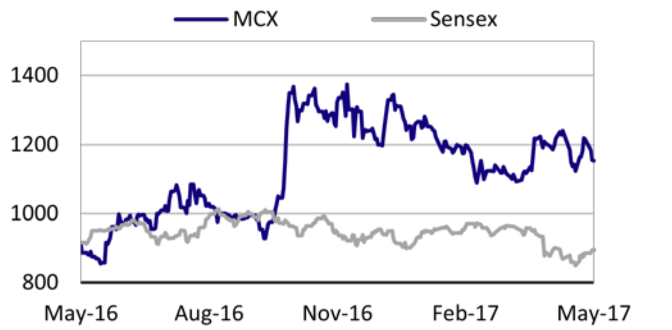
Y/E Mar	2012	2013	2014	2015	2016	2017	2018E	2019E
Adjusted EBITDA	3,347	2,932	1,248	689	553	589	782	1,512
Non cash opr. exp (inc)	-650	319	1,085	0	0	0	0	0
(Inc)/Dec in Wkg. Cap.	1,160	-1,941	-1,565	503	22	-1,251	1,277	-214
Tax Paid	-1,097	-782	-384	-220	-41	-129	-112	-300
Other operating activities	0	0	0	0	0	0	0	0
CF from Op. Activity	**2,760**	**529**	**385**	**972**	**533**	**-791**	**1,948**	**998**
(Inc)/Dec in FA & CWIP	-200	-462	-59	-9	-200	-345	-242	-266
Free cash flows	**2,561**	**68**	**325**	**963**	**333**	**-1,137**	**1,706**	**732**
(Pur)/Sale of Invt	-2,723	1,910	586	-1,080	5,367	1,950	1,104	1,189
Others	0	0	0	0	0	0	0	0
CF from Inv. Activity	**-2,923**	**1,448**	**527**	**-1,089**	**5,167**	**1,605**	**862**	**923**
Inc/(Dec) in Net Worth	0	0	0	0	0	0	0	0
Inc / (Dec) in Debt	0	0	0	0	0	0	0	0
Interest Paid	0	0	0	0	-14	0	-2	-2
Divd Paid (incl Tax) & Others	-23	-2,134	-1,133	0	0	-925	-765	-1,074
CF from Fin. Activity	**-24**	**-2,134**	**-1,133**	**0**	**-14**	**-925**	**-767**	**-1,076**
Inc/(Dec) in Cash	**-186**	**-156**	**-221**	**-117**	**5,687**	**-112**	**2,042**	**845**
Add: Opening Balance	3,310	3,124	3,475	3,417	2,655	5,003	3,890	5,932
Closing Balance	**3,124**	**2,968**	**3,254**	**3,300**	**8,342**	**4,891**	**5,932**	**6,777**

Corporate profile

Company description

MCX, India's largest and only listed exchange, commenced operations on 10 November 2003. It is an electronic commodity futures exchange, with a scalable technology framework and disaster recovery site (DRS) for end-to-end functioning of systems and network. MCX had 84% market share in terms of the value of commodities traded in the futures market in FY15. MCX has a pan India presence, with over 2,000 members, and operations through 486,700+ terminals, across 1,879 cities and towns.

Exhibit 1: Sensex rebased



Source: MOSL/Bloomberg

Exhibit 2: Shareholding pattern (%)

	Mar-17	Dec-16	Mar-16
Promoter	0.0	0.0	0.0
DII	36.5	37.5	41.6
FII	22.6	24.0	15.7
Others	40.9	38.5	42.8

Note: FII Includes depository receipts Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
KOTAK MAHINDRA BANK LIMITED	15.0
AXIS MUTUAL FUND	4.4
JHUNJHUNWALA RAKESH RADHESHYAM	3.9
RELIANCE MUTUAL FUND	3.0
IDFC PREMIER EQUITY FUND	2.2

Source: Capitaline

Exhibit 4: Top management

Name	Designation
Saurabh Chandra	Chairman
Mrugank Paranjape	Managing Director & CEO
Ajay Puri	Company Secretary
Parveen Kumar Singhal	President & Whole-time Dir.

Source: Capitaline

Exhibit 5: Directors

Name	Name
Arun Bhargava	Prithvi Haldea
Ajay Kumar	Amit Goela
Chengalath Jayaram	Hemang Raja
M A K Prabhu	Madhu Jayakumar
Padma Raghunathan	Arun Nanda
Govinda Rao Marapalli	PRAVIN TRIPATHI
S K Mitra	

*Independent

Exhibit 6: Auditors

Name	Type
Rathi & Associates	Secretarial Audit
Shah Gupta & Co	Statutory

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY17	24.8	26.8	-7.4
FY18	30.5	33.1	-7.8
FY19	42.9	42.1	1.9

Source: Bloomberg

N O T E S

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