MOTILAL OSWAL

23 October 2018

2QFY19 Results Update | Sector: Technology

MCX

BSE SENSEX	S&P CNX
33,847	10,147

Bloomberg	MCX IN
Equity Shares (m)	51
M.Cap.(INRb)/(USDb)	37.8 / 0.5
52-Week Range (INR)	1111 / 650
1, 6, 12 Rel. Per (%)	7/-2/-36
12M Avg Val (INR M)	492
Free float (%)	100.0

Financials & Valuations (INR b)

Y/E March	2018	2019E	2020E
Net Sales	2.6	2.9	3.3
EBITDA	0.7	1.0	1.2
NP	1.1	1.0	1.4
EPS (INR)	21.2	20.4	28.3
EPS Gr. (%)	-14.6	-3.7	38.8
BV/Sh. (INR)	269.9	240.1	329.2
RoE (%)	7.9	8.0	10.0
RoCE (%)	7.7	9.4	9.6
Payout (%)	97.0	118.4	85.3
Div. Yield	2.9	3.4	3.4

Estimate change ↓

TP change ↓

Rating change ↔

CMP: INR741 TP: INR875 (+18%) Buy

Gold and Crude ensuring volume growth

Operating profits below estimate

- Revenue increased 5.7% YoY to INR711m (2% below our estimate of INR726m) in 2QFY19. Lower-than-estimated revenues in the case of MCX are explained by either realization (mix of high- and low-volume orders) or by contribution of non-transaction revenues.
- EBITDA margin of 32.2% missed our estimate of 38%, led by [1] lower revenues and [2] higher Software expenses (INR145m v/s estimate of INR115m).
- PAT increased 23.3% YoY to INR359m (7.6% beat) owing to a lower tax rate (13% v/s 25%), which emanated from some excess provisions written back and deferred tax.

Expect monetization of Options in FY20: MCX is expected to start monetizing Options in FY20, and there will be no transaction charges in 2HFY19 either. Also, it expects the regulators to allow trading in index products in the next six months, which will support volumes.

Valuation View: We expect volumes/revenue/earnings CAGR (FY18-20) of 19%/13%/16%. BSE, too, launched commodity derivatives in Bullion in October 2018 and is already clocking ~10% of MCX's volumes in Gold. In our view, this merits caution not only from the perspective of potential loss of market share, but also in terms of any unexpected cut in pricing in the near future. Management denied any plans to cut prices for now. However, owing to the early developments and staying cognizant of the potential turn of events going forward, we are revising our target multiple for MCX to 25x (from 30x earlier). Our revised TP of INR875 implies an upside of 18%. Maintain **Buy**.

MCX Quarterly Performance (INR Million)

	FY18				FY19				FY18	FY19E	Est.	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			2Q	(%/bp)
Sales	592	673	610	706	729	711	732	754	2,580	2,926	726	(2.1)
Q-o-Q Gr. (%)	-5.5	13.6	-9.4	15.8	3.2	-2.4	3.0	3.0	-2.3	13.4	-0.4	-206bp
Staff Costs	178	178	169	155	180	174	184	186	680	724	182	(4.2)
Other expenses	282	288	306	310	311	312	313	314	1,186	1,144	268	16.4
Depreciation	48	48	35	36	37	38	41	41	167	156	41	(6.3)
EBIT	84	158	101	205	201	187	195	214	548	902	236	(20.9)
Margins (%)	14.2	23.6	16.5	29.0	27.6	26.3	26.6	28.3	21.2	30.8	32.5	-624bp
Other Income	277	243	156	242	100	222	224	230	917	776	210	5.6
PBT bef. Exceptional items	361	401	256	447	301	408	419	444	1,465	1,678	445	(8.2)
Tax	98	110	68	107	22	53	115	120	383	311	111	(52.0)
Rate (%)	27.2	27.3	26.7	24.0	7.4	13.1	27.5	27.2	26.2	18.6	25.0	-1195bp
PAT	263	292	188	340	279	355	304	323	1,081	1,366	334	6.3
Q-o-Q Gr. (%)	20.0	11.0	-35.6	80.9	-17.9	27.4	-14.4	6.2	-17.4	26.4	19.8	
EPS (INR)	5.1	5.7	3.7	6.7	1.2	7.0	6.8	7.1	21.2	26.8	6.6	6.7
Total volumes (INR t)	12.0	14.1	12.8	15.0	16.2	16.6	16.8	17.4	53.9	66.9	16.6	
Q-o-Q Gr. (%)	-3.4	17.0	-8.8	17.3	7.6	2.2	1.4	3.7			2.2	
Y-o-Y Gr. (%)	-24.8	-14.0	-7.6	20.9	34.7	17.7	31.0	15.8	-8.1	24.1	17.7	

E: MOSL Estimates

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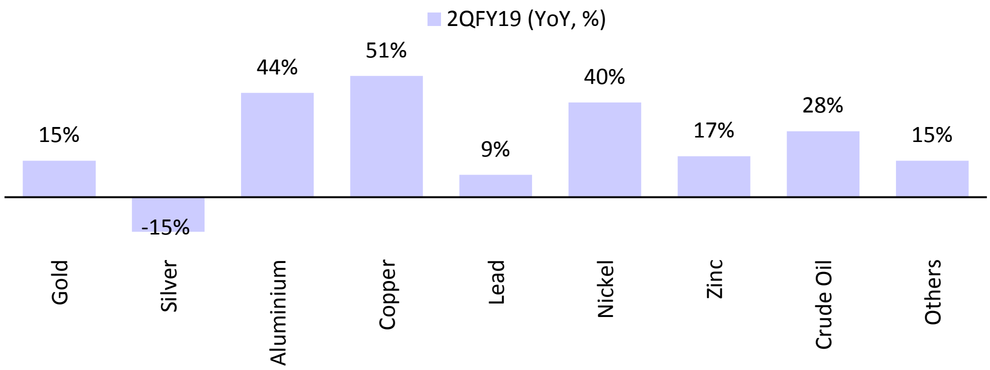
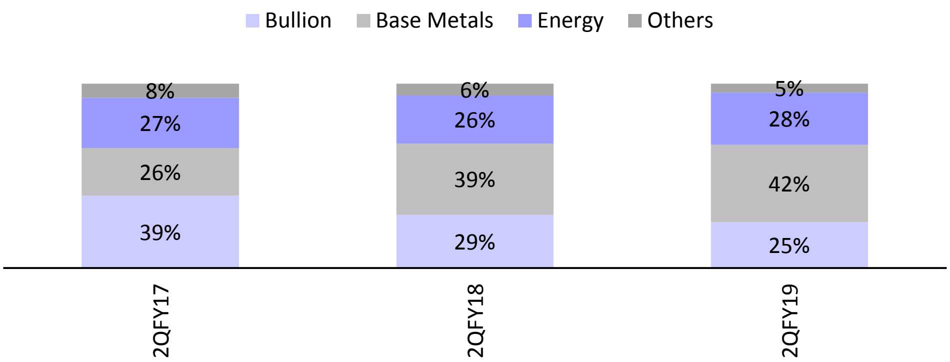
Exhibit 1: Volumes up in most commodities YoY



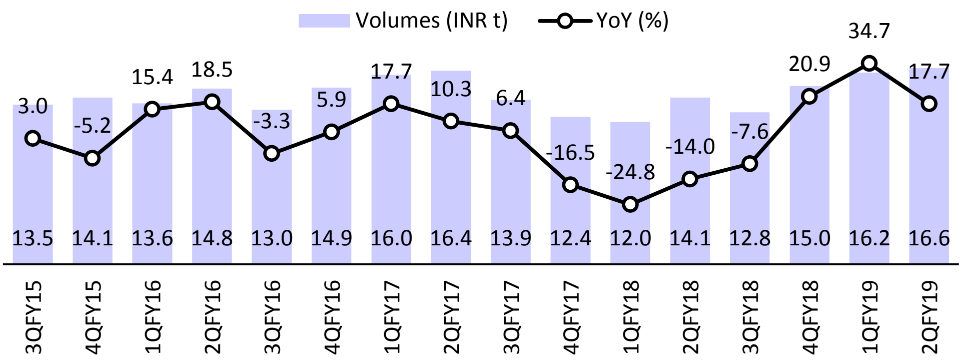
Source: Company, MOSL

Exhibit 2: Bullion composition dragged by Silver, while Base Metals is up 3pp



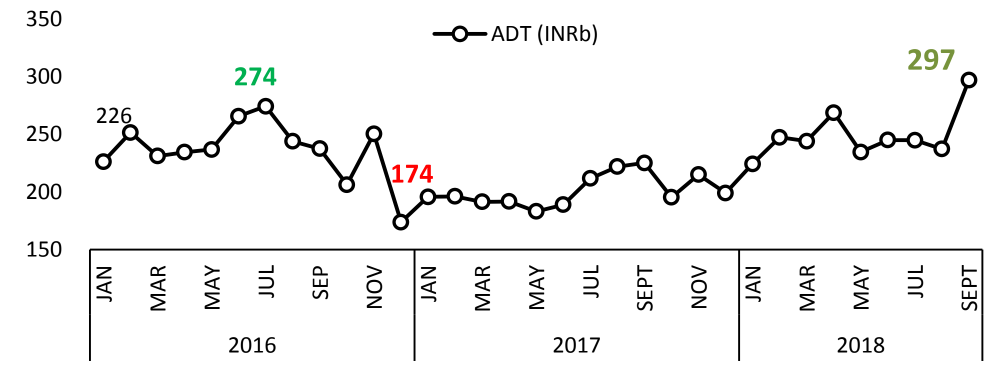
Source: Company, MOSL

Exhibit 3: MCX maintained its outlook of 15% CAGR in ADTV



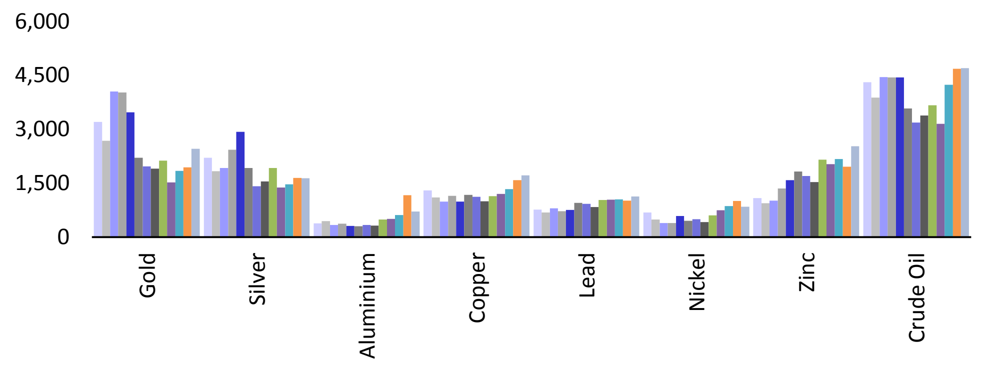
Source: Company, MOSL

Exhibit 4: Highest ever ADT in past two years (including Options)



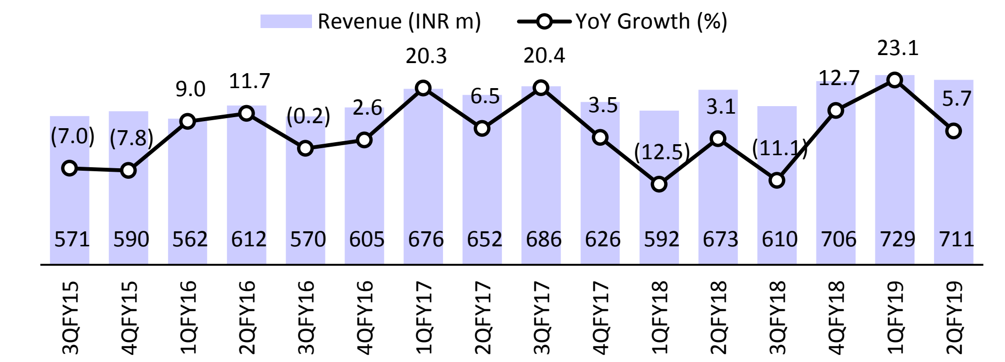
Source: Company, MOSL

Exhibit 5: …Aided by strength across Gold and Crude (quarterly data in INRb of value traded)



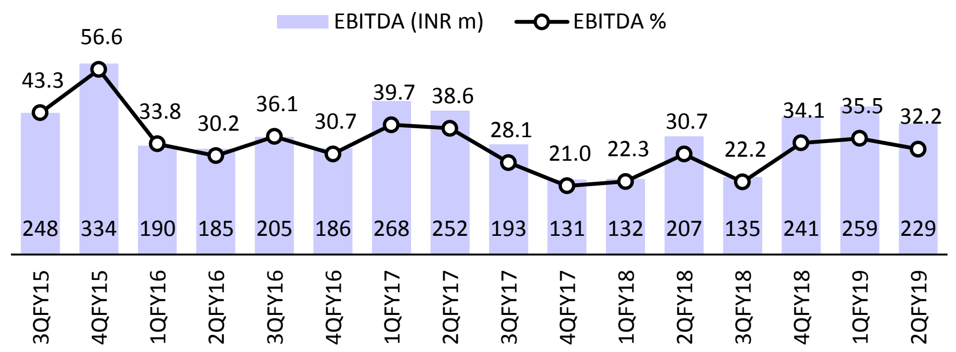
Source: Company, MOSL

Exhibit 6: Rebates via liquidity enhancement scheme drove QoQ revenue decline



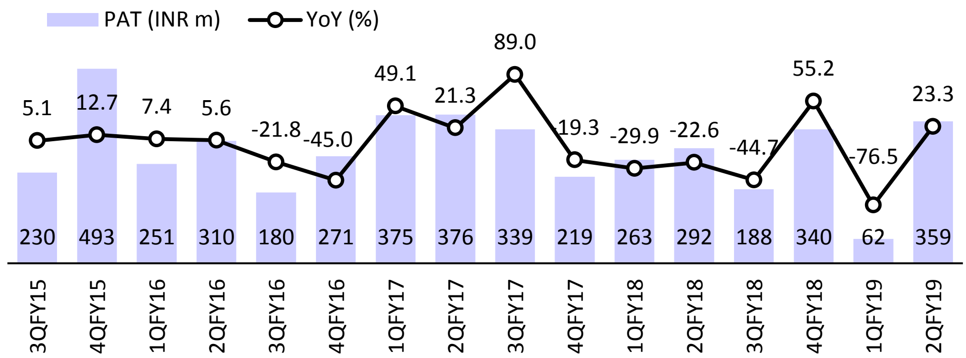
Source: Company, MOSL

Exhibit 7: Stable cost structure over the last few quarters



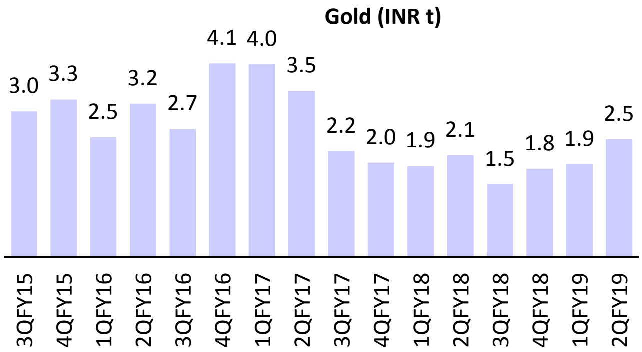
Source: Company, MOSL

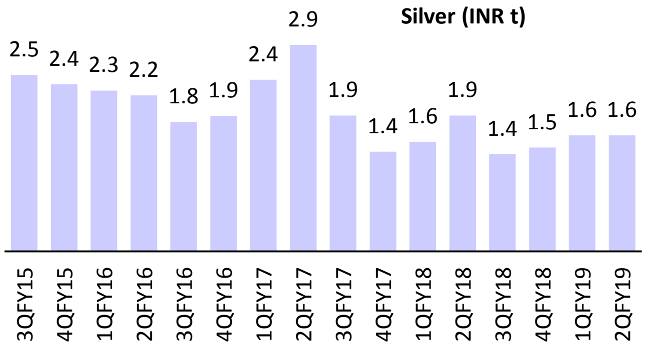
Exhibit 8: PAT beat led by lower tax and marginally higher other income



Source: Company, MOSL

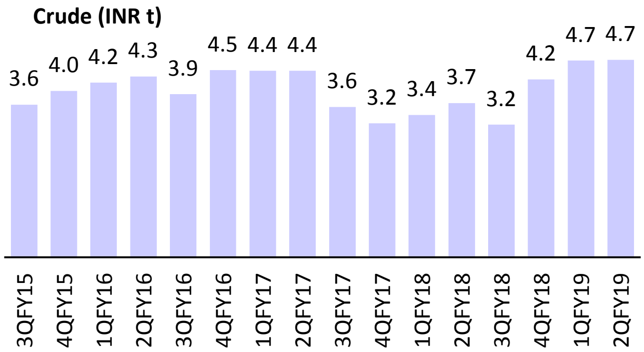
Exhibit 9: Slight pickup seen in Bullion volumes

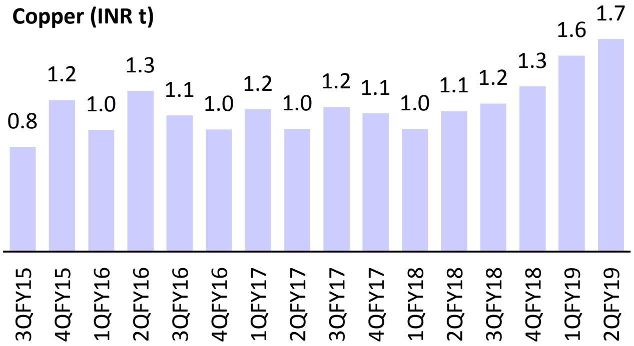




Source: Company, MOSL

Exhibit 10: Copper continued to show healthy trends, while Crude was stable





Source: Company, MOSL

Takeaways from Management Commentary

- **Positive regulatory developments**: SEBI has cleared proposal for EFEs (eligible foreign entities). This may not immediately translate into large volumes, but will help open interest. Second, RBI did not allow international hedging of Gold on international exchanges. OI on Gold moved up from 7.5-8 tonnes to 15 tonnes. Discussions on index have gained traction, and that could come in the next six months. Slow progress on introduction of institutional participation.
- **Charging on Options**: Options are still below the threshold at which the company will be comfortable to start charging. That said, while charge won't be levied in FY19, MCX will start to monetize the segment from next fiscal.
- **Banking channel**: Large bank members are becoming distributors. Activation of large institutions takes time. Axis Securities was added as a member in January and started trading in August. This is in line with the normal gestation. Over three years' time this should add ~10-15% of overall volumes.
- **Competition**: It may help grow the market rather than cannibalize MCX's share. At least the initial signs looking at volumes on BSE and MCX are reflective of the same.
- **Growth outlook**: Generic growth of 8-10% should continue. New products should drive further and hence 15% CAGR in ADTV is a number that is achievable.

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.
- **New products / participants will keep ticking the ADT:** Our base case assumes gradual recovery in volumes to INR240b-270b in FY19E and INR280-310b in FY20E, yet lower than pre-commodities transaction tax (CTT) average daily turnover of INR450b-500b. This compares with current ADT of INR200b-225b.
- **Volumes have taken a temporary hit:** Volumes suffered 2HFY17 onwards 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, December 2017 marks one year from the commencement of problems, and the base would hence normalize 4QFY18 onwards. While bullion remains lower than pre-demonetization levels, a good contribution has been made by a rally in base metals. Options are on the verge of being launched, and will result in a further volume boost once they start trading.
- **Multiplier effect on operational earnings from operating leverage, Buy:** Options are currently active in multiple commodities, though the pick-up remains slow and gradual. Uptick in volumes should continue with the entry of new participants such as FIs and new products such as indices. This drives our expectation of sanguine revenue growth over FY18-20 (16%) and consequently driving earnings growth (26%). However, BSE too launched commodity derivatives in Bullion in October 2018, and is already clocking ~10% of MCX's volumes in Gold. We believe that this merits caution not only in terms of potential loss of market share; but also in terms of any unexpected cut in pricing. The management denied any plans to cut prices for now. However, staying cognizant of the potential turn of events going by early developments,

we are revising our target multiple for MCX to 25x, down from 30x earlier. Our revised price target of INR1000 implies 25.7% 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 valautions

Income statement								(INR m)
Y/E March	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19E**	**FY20E**
Sales	**5,160**	**3,407**	**2,225**	**2,349**	**2,641**	**2,580**	**2,917**	**3,298**
Change (%)	(2)	(34)	(35)	6	12	(2)	13	13
Cost of Services	1,072	935	733	779	1,071	1,174	1,294	1,379
SG&A Expenses	812	1,014	616	804	726	691	641	682
EBITDA	**3,276**	**1,457**	**876**	**766**	**844**	**715**	**982**	**1,238**
% of Net Sales	63	43	39	33	32	28	34	38
Depreciation	307	343	259	246	186	167	149	154
Interest	0	11	14	0	2	-	-	-
Other Income	1,259	993	1,098	977	1,164	917	729	843
EO Item (net)	-	-	-	667	-	-	238	-
PBT	**4,227**	**2,097**	**1,701**	**831**	**1,821**	**1,465**	**1,324**	**1,927**
Tax	1,065	569	450	413	512	383	282	482
Rate (%)	25	27	26	50	28	26	21	25
PAT	**3,162**	**1,528**	**1,251**	**418**	**1,309**	**1,081**	**1,042**	**1,445**
Net Income	**3,162**	**1,528**	**1,251**	**418**	**1,309**	**1,081**	**1,042**	**1,445**
Change (%)	10	(52)	(18)	(67)	213	(17)	(4)	39

Balance Sheet								(INR m)
Y/E March	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19E**	**FY20E**
Share Capital	510	510	510	510	510	510	510	510
Reserves	11,058	10,931	11,512	11,529	13,078	13,253	11,737	16,277
Net Worth	**11,567**	**11,441**	**12,022**	**12,039**	**13,588**	**13,763**	**12,247**	**16,787**
SGF		1,720	1,871	1,879	1,705	1,806	2,412	1,705
Loan & other long term liab.	569	449	343	282	420	408	753	420
Capital Employed	**12,136**	**13,610**	**14,236**	**14,201**	**15,713**	**15,977**	**15,412**	**18,912**
Net Block	**2,044**	**1,735**	**1,553**	**1,430**	**1,633**	**3,624**	**3,282**	**1,305**
Other LT Assets	531	281	281	281	281	281	281	281
Investments	1,481	132	132	2,230	4,404	5,316	4,889	4,889
Curr. Assets	**13,802**	**15,267**	**16,278**	**14,227**	**12,340**	**10,393**	**11,042**	**16,391**
Current Investments	9,201	10,766	12,795	8,511	7,544	8,878	6,154	7,544
Debtors	69	90	107	42	28	63	83	114
Cash & Bank Balance	3,475	3,417	2,655	5,003	3,890	596	3,867	7,133
Loans & Advances	530	676	456	268	3	3	8	11
Other Current Assets	525	319	265	404	875	854	930	1,589
Current Liab. & Prov	**5,721**	**3,805**	**4,007**	**3,967**	**2,945**	**3,636**	**4,083**	**4,212**
Net Current Assets	**8,080**	**11,462**	**12,271**	**10,260**	**9,395**	**6,757**	**6,959**	**12,179**
Application of Funds	**12,136**	**13,610**	**14,236**	**14,201**	**15,713**	**15,977**	**15,412**	**18,654**

E: MOSL Estimates

Financials and valautions

Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Basic (INR)								
EPS	**58.6**	**30.0**	**24.6**	**23.4**	**24.8**	**21.2**	**20.4**	**28.3**
Cash EPS	68.0	36.9	29.6	13.0	29.3	24.5	23.3	31.4
Book Value	226.8	225.4	235.8	236.1	266.4	269.9	240.1	329.2
DPS	0.5	10.2	10.2	-	15.3	17.3	20.4	20.4
Payout %	0.9	39.0	48.5	-	70.7	97.0	118.4	85.3
Valuation (x)								
P/E	12.7	24.7	30.1	31.7	29.9	34.9	36.3	26.1
Cash P/E	10.9	20.1	25.0	56.9	25.3	30.3	31.7	23.6
EV/EBITDA	7.8	16.3	25.8	32.0	31.6	40.0	28.9	22.4
EV/Sales	4.9	7.0	10.1	10.4	10.1	11.1	9.7	8.4
Price/Book Value	3.3	3.3	3.1	3.1	2.8	2.7	3.1	2.3
Dividend Yield (%)	0.1	1.6	1.6	-	2.4	2.8	3.3	3.3
Profitability Ratios (%)								
RoE	29.4	13.3	10.7	3.5	10.2	7.9	8.0	10.0
RoCE	28.1	12.8	10.4	8.8	10.0	7.7	9.4	9.6
RoIC	(173.6)	(145.9)	(50.7)	(99.5)	19.1	7.5	11.0	17.4
Turnover Ratios								
Debtors (Days)	5	10	17	7	4	9	10	10
Fixed Asset Turnover (x)	28	19	12	13	14	13	15	16

Cash Flow Statement **(INR m)**

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
CF from Operations	2,470	1,949	617	705	647	595	731	974
Cash for Working Capital	(1,941)	(1,565)	503	22	(1,251)	767	1,296	(14)
Net Operating CF	**529**	**385**	**1,120**	**727**	**(604)**	**1,362**	**2,027**	**960**
Net Purchase of FA	(462)	(59)	(9)	(200)	(345)	(237)	(261)	(287)
Free Cash Flow	**68**	**325**	**1,111**	**527**	**(950)**	**1,125**	**1,766**	**673**
Net Purchase of Invest.	1,910	586	(1,214)	5,174	1,810	(681)	3,269	626
Net Cash from Invest.	**1,448**	**527**	**(1,222)**	**4,974**	**1,464**	**(918)**	**3,008**	**339**
Proc. from equity issues	-	-	-	-	-	-	-	-
Proceeds from LTB/STB	-	-	-	-	-	-	-	-
Dividend Payments	(2,134)	(1,133)	-	-	(925)	(1,048)	(629)	(710)
Cash Flow from Fin.	**(2,134)**	**(1,133)**	**-**	**-**	**(925)**	**(1,048)**	**(629)**	**(710)**
Others		-	-					
Net Cash Flow	**(156)**	**(221)**	**(103)**	**5,701**	**(65)**	**(605)**	**4,407**	**588**
Opening Cash Bal.	**3,124**	**3,475**	**3,417**	**2,655**	**5,003**	**3,890**	**596**	**3,867**
Add: Net Cash	(156)	(221)	(103)	5,701	(65)	(605)	4,407	588
Closing Cash Bal.	**2,968**	**3,255**	**3,315**	**8,356**	**4,938**	**3,285**	**5,003**	**4,456**

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst becomes inconsistent with the investment rating legend, the Research Analyst shall within 28 days of the inconsistency, take appropriate measures to make the recommendation consistent with the investment rating legend.

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