Multi Commodity Exchange

BUY

INDUSTRY			EXCHANGES
CMP *(as on 26 Feb 2015)*			Rs 1,039
Target Price			Rs 1,180
Nifty			8,684
Sensex			28,747
KEY STOCK DATA			
Bloomberg			MCX IN
No. of Shares (mn)			51
MCap (Rs bn) / ($ mn)			53/858
6m avg traded value (Rs mn)			660
STOCK PERFORMANCE (%)			
52 Week high / low			Rs 1,081/425
	3M	6M	12M
Absolute (%)	20.2	27.3	98.2
Relative (%)	19.0	18.6	61.3
SHAREHOLDING PATTERN (%)			
Promoters			-
FIs & Local MFs			35.99
FIIs			20.29
Public & Others			43.72

Source : BSE

Vivekanand Subbaraman
vivekanand.s@hdfcsec.com
+91-22-6171-7321

Still a lot to play for

We organized investor interactions with the senior management of MCX. The management highlighted several potential regulatory tailwinds including (1) rationalization of the commodities transaction tax (CTT) (2) merger of the Securities Exchange Bureau of India (SEBI) and the Forward Markets Commission (FMC).

Average daily traded volume (ADTV) is gradually improving as the company has started refocusing on its market development efforts. The company mentioned that future growth would be driven by contract launches in base metals and agri commodities such as cotton.

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. We continue to value MCX at 25x FY17E EPS arriving at a target price of Rs 1,180. Below are key highlights of the investor interactions:

- **Regulatory triggers in the offing:** MCX mentioned that the commodity exchanges, FMC, members (brokers) and industry associations have appealed to the government to do away with CTT. The government has netted just Rs 8.5bn in the last 18 months though the CTT and management reiterated that this tax makes Indian commodity exchanges extremely uncompetitive versus global exchanges (CME, LME etc), impeding the development of a commodity derivatives ecosystem. ***Considering the government's 'Make In India' focus, MCX believes that the government could rationalize CTT and facilitate creation of a transparent marketplace for commodities***.
- The government is also considering a merger between SEBI and FMC. Such a move would result in an autonomous commodity derivatives regulator, which would have punitive power to crackdown on illegal Dabba trading (bucket shops). Management believes that this could result in improvement of exchange volumes (20-25% in year) as Dabba trading volumes could be as high as 10x exchange volumes.
- **Improving operating performance, base metals and cotton could be future growth areas:** ADTV has improved to Rs 230-240bn, comparable to adjusted pre-crisis, post-CTT ADTV. MCX has resumed market outreach efforts to grow business. Deliverable base metal contracts and cotton could be future growth areas for the company. However, new contract success is fraught with challenges, such as contract standardization, warehousing capabilities, taxation etc.
- **Key investor concerns** include MCX's dependence on FTIL for software support. Additionally, lack of clarity on the use of surplus cash remains a sore point.

FINANCIAL SUMMARY

(Rs mn)	FY13	FY14	FY15E	FY16E	FY17E
Net Sales	4,992	3,197	2,079	3,131	4,113
EBITDA	3,152	1,457	726	1,627	2,452
PAT	2,986	1,528	1,167	1,755	2,403
EPS (Rs)	58.9	30.2	22.9	34.4	47.1
P/E (x)	17.7	34.4	45.4	30.2	22.1
P/BV (x)	4.6	4.6	4.9	4.7	4.3
RoE (%)	27.8	13.3	10.5	15.9	20.4

Source : Company, HDFC sec Inst Research

Valuation

- We expect MCX to show a robust 44% FY15-17 earnings CAGR driven by revenue growth of 41% CAGR during the same period. Considering the asset-light nature of the business, we expect RoE to nearly double to 20.4% in FY17. MCX currently trades at 25x FY16 and 18x FY17 EPS. **We believe that the company can sustain the multiples that it currently commands and hence we assign a target multiple of 25x FY17 EPS.**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

- *We believe that will continue to trade at premium valuations (30x FY16E EPS – 50% premium to global peers), on account of the company's robust growth trajectory.*
- *We expect MCX's EPS to grow at 44% CAGR from FY15-17, versus 13%, which is the average EPS growth of listed peers*
- *MCX trades at a PEG of 0.5, comparing favourably to global exchanges, which trade at a PEG of 1.7*

VALUATION : GLOBAL EXCHANGES

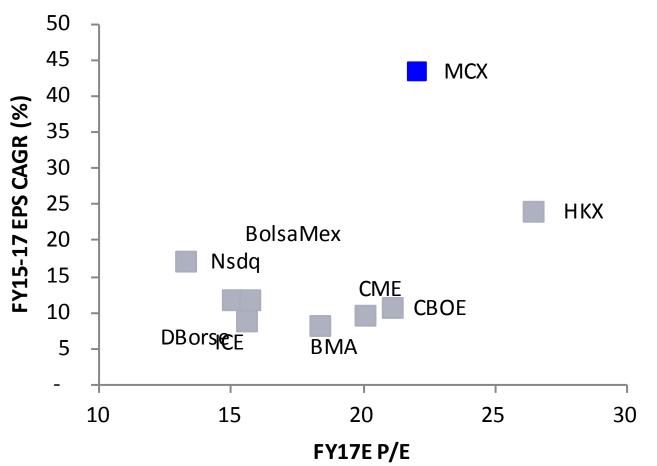
	Country	M-Cap (US$ mn)	Forward P/E (x) 1-yr fwd	Forward P/E (x) 2-yr fwd	EPS growth (2-yr CAGR)	PEG (x)	Forward P/B (x) 1-yr fwd	Forward P/B (x) 2-yr fwd	EV/EBITDA (x) 1-yr fwd	EV/EBITDA (x) 2-yr fwd	ROE (%) 1-yr fwd	ROE (%) 2-yr fwd
Emerging markets												
MCX (HDFC Sec estimates)	India	879	30.2	22.1	43.5	0.51	4.7	4.3	25.2	16.1	15.9	20.4
Bloomberg Consensus estimates												
BM&FBovespa SA	Brazil	6,369	11.1	9.6	14.9	0.64	0.9	0.9	10.3	9.1	8.2	10.4
Bursa Malaysia Bhd	Malaysia	1,214	20.0	18.4	8.2	2.24	5.8	5.6	10.8	10.0	28.4	31.0
Bolsa Mexicana	Mexico	1,008	16.7	15.0	11.8	1.28	2.8	2.6	10.2	9.2	15.7	17.9
Multi Commodity Exchange	India	879	32.7	25.8	32.8	0.79	4.8	4.1	19.5	15.4	13.1	15.7
EM average			**20.1**	**17.2**	**16.9**	**1.23**	**3.6**	**3.3**	**12.7**	**10.9**	**16.4**	**18.8**
Developed markets												
CME Group	USA											
Hong Kong Exchanges	Hong Kong	32,394	22.0	20.1	9.6	2.08	1.5	1.5	13.2	12.0	6.3	6.4
Intercontinental Exchange	USA	26,754	30.2	26.5	24.0	1.10	10.1	9.0	0.6	0.5	31.3	33.9
Deutsche Boerse	Germany	26,381	17.1	15.6	8.8	1.76	2.2	1.8	11.6	10.2	10.7	10.4
London Stock Exchange	UK	16,107	17.4	15.7	11.8	1.33	4.2	3.3	11.9	10.7	20.5	19.8
Nasdaq OMX	USA	13,727	20.6	17.7	13.2	1.34	353.1	321.2	10.4	8.9	18.6	22.4
Japan Exchange Group	Japan	8,551	13.9	13.3	17.1	0.77	1.5	1.4	9.0	8.4	9.8	10.1
Singapore Exchange	Singapore	7,061	22.3	21.2	10.5	2.03	3.9	3.5	12.0	11.5	15.7	15.0
ASX	Australia	6,484	22.5	19.7	14.2	1.38	10.5	8.6	15.9	14.0	39.1	41.4
CBOE Holdings	USA	6,679	20.3	19.2	5.3	3.65	2.3	2.2	13.3	12.7	11.0	11.5
Hellenic Exchanges	Greece	5,266	23.0	21.1	10.7	1.97	21.1	16.1	11.9	11.1	76.7	79.6
NZX Ltd	New Zealand	491	17.4	15.4	15.6	0.99	2.3	2.3	8.2	7.2	12.1	14.0
Developed markets average		222	16.6	14.6	8.8	1.67	5.7	6.6	9.5	8.6	31.2	33.9
Global average			**20.3**	**18.3**	**12.5**	**1.67**	**34.9**	**31.5**	**10.6**	**9.7**	**23.6**	**24.9**

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

MCX – Sensitivity of target price to ADTV assumptions

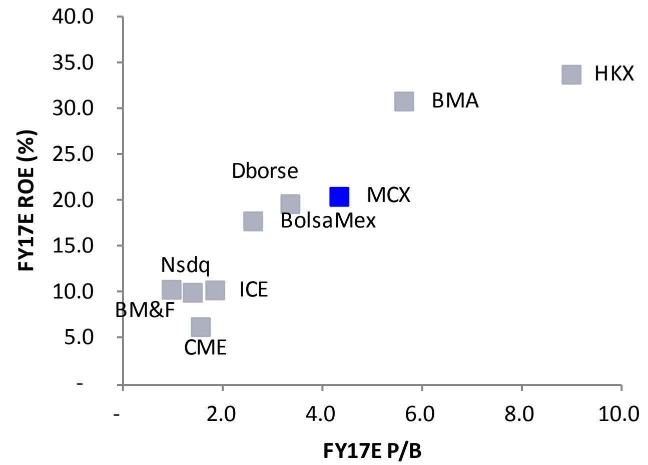
Target price (Rs)		FY17e PE (x)					FY17e ADTV (Rs bn)
		20.0	22.0	**25.0**	28.0	30.0	
	75%	824	906	**1,030**	1,153	1,236	377
	80%	883	971	**1,104**	1,236	1,325	402
FY17e ADTV (% of FY12 peak)	**85%**	**942**	**1,036**	**1,178**	**1,319**	**1,413**	**428**
	90%	1,001	1,102	**1,252**	1,402	1,502	453
	95%	1,061	1,167	**1,326**	1,485	1,591	478

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**	**2,079**	**3,131**	**4,113**
Growth (%)	***(5.1)***	***(35.9)***	***(35.0)***	***50.6***	***31.3***
Software support charges	782	622	389	456	554
Employee Expenses	289	313	362	412	464
SG&A Expenses	206	200	214	235	259
Other Operating Expenses	810	814	597	647	681
Operating Profits	**2,904**	**1,248**	**518**	**1,381**	**2,154**
Operating Profit Margin (%)	***58.2***	***39.0***	***24.9***	***44.1***	***52.4***
Other Operating Income	248	209	208	245	297
EBITDA	**3,152**	**1,457**	**726**	**1,627**	**2,452**
EBITDA (%)	***60.2***	***42.8***	***31.7***	***48.2***	***55.6***
EBITDA Growth (%)	***(10.3)***	***(53.8)***	***(50.2)***	***124.1***	***50.7***
Other Income	1,207	993	1,046	991	1,076
Depreciation	307	343	273	277	282
EBIT	**4,052**	**2,107**	**1,498**	**2,340**	**3,247**
Interest	0	11	15	-	-
PBT	4,051	2,096	1,483	2,340	3,247
Tax	1,065	569	316	585	844
PAT	**2,986**	**1,528**	**1,167**	**1,755**	**2,403**
EO items (net of tax)	-	-	-	-	-
APAT	**2,986**	**1,528**	**1,167**	**1,755**	**2,403**
APAT Growth (%)	***(0.6)***	***(48.8)***	***(23.6)***	***50.4***	***36.9***

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	10,218	10,820	11,733
Total shareholders' Funds	**11,546**	**11,441**	**10,728**	**11,330**	**12,243**
Settlement guarantee fund	21	1,720	1,720	1,978	2,275
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**	**12,897**	**13,758**	**14,967**
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	12,444	14,469	16,685
ST Loans & Advances, Others	1,125	1,084	822	916	1,023
Total Current Assets	13,802	13,984	13,265	15,385	17,708
Trading margin from members	4,324	2,585	1,617	2,474	3,286
Other Current Liabilities & Provns	1,398	1,221	826	1,201	1,521
Total Current Liabilities	**5,721**	**3,805**	**2,443**	**3,675**	**4,807**
Net Current Assets	**8,080**	**10,179**	**10,823**	**11,710**	**12,901**
TOTAL APPLICATION OF FUNDS	**12,136**	**13,610**	**12,897**	**13,758**	**14,967**

Source: Company, HDFC sec Inst Research

CASH FLOW (Standalone)

(Rs mn)	FY13	FY14	FY15E	FY16E	FY17E
Reported PAT	**2,986**	**1,528**	**1,167**	**1,755**	**2,403**
Non-operating & EO items	(1,114)	(779)	(1,046)	(991)	(1,076)
PAT from Operations	**1,872**	**748**	**121**	**764**	**1,326**
Interest expenses	0	11	15	-	-
Depreciation	307	343	273	277	282
Working Capital Change	(3,523)	(1,465)	(1,100)	1,137	1,025
OPERATING CASH FLOW (a)	**529**	**385**	**(690)**	**2,179**	**2,633**
Capex	(462)	(59)	(200)	(250)	(300)
Free cash flow (FCF)	68	326	(890)	1,929	2,333
Investments	1,333	67	-	-	-
INVESTING CASH FLOW (b)	**872**	**8**	**(200)**	**(250)**	**(300)**
Debt Issuance	-	-	-	-	-
Interest expenses	(0)	(0)	(15)	-	-
FCFE	1,401	393	(905)	1,929	2,333
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)**	**(1,487)**	**1,034**	**1,140**
Non-operating and EO items	576	519	1,031	991	1,076
Closing Cash & Equivalents	752	530	12,444	14,469	16,685

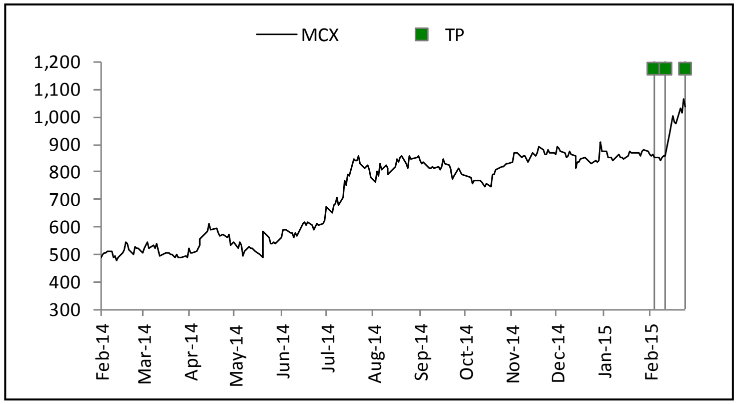
Source: Company, HDFC sec Inst Research

KEY RATIOS (Standalone)

	FY13	FY14	FY15E	FY16E	FY17E
PROFITABILITY (%)					
GPM	85.1	81.8	83.0	86.5	87.4
EBITDA Margin	60.2	42.8	31.7	48.2	55.6
APAT Margin	57.0	44.8	51.0	52.0	54.5
RoE	27.8	13.3	10.5	15.9	20.4
RoIC or Core RoCE	31.9	20.8	25.6	32.3	37.7
RoCE	16.7	8.8	7.7	10.1	12.2
EFFICIENCY					
Tax Rate (%)	25.2	29.3	21.3	25.0	26.0
Asset Turnover (x)	0.3	0.2	0.1	0.2	0.2
Debtors (days)	228	242	131	99	85
Payables (days)	102	139	251	328	372
Cash Conversion Cycle (days)	126	103	(120)	(229)	(287)
Debt/EBITDA (x)	(2.7)	(7.1)	(14.9)	(7.4)	(5.5)
Net D/E	(0.7)	(0.9)	(1.0)	(1.1)	(1.1)
Interest Coverage	13,069	198	NM	NM	NM
PER SHARE DATA					
EPS (Rs/sh)	58.9	30.2	22.9	34.4	47.1
CEPS (Rs/sh)	64.9	36.9	28.2	39.9	52.6
DPS (Rs/sh)	24.0	10.0	10.0	15.0	20.0
BV (Rs/sh)	226.4	224.3	210.4	222.2	240.1
VALUATION					
P/E	14.6	28.5	45.4	30.2	22.1
P/BV	3.8	3.8	4.9	4.7	4.3
EV/EBITDA	11.3	23.0	58.1	25.2	16.1
OCF/EV (%)	1.49	1.15	(1.64)	5.32	6.65
FCF/EV (%)	0.19	0.97	(2.11)	4.71	5.89
FCFE/mkt cap (%)	0.32	0.09	(0.17)	0.36	0.44
Dividend Yield (%)	2.79	1.16	0.96	1.44	1.92

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
05-Feb-15	859	BUY	1,180
16-Feb-15	860	BUY	1,180
27-Feb-15	1,039	BUY	1,180

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

Disclosure:
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HDFC securities
Institutional Equities
Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,
Senapati Bapat Marg, Lower Parel,Mumbai - 400 013
Board : +91-22-6171 7330www.hdfcsec.com