

Stock Update

Multi Commodity Exchange of India Ltd.

December 16, 2021





Multi Commodity Exchange of India Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Exchange	Rs.1758	Buy at LTP of Rs.1758 & add more on dips of Rs.1591	Rs.1950	Rs.2070	2 quarters

HDFC Scrip Code	MCXLTDEQNR
BSE Code	534091
NSE Code	MCX
Bloomberg	MCX IN
CMP Dec 15, 2021	1758
Equity Capital (Rs mn)	510
Face Value (Rs)	10
Equity Share O/S (mn)	51
Market Cap (Rs bn)	89.63
Book Value (Rs)	278.6
Avg. 52 Wk Volumes	690527
52 Week High	2,134.9
52 Week Low	1,434.8

Share holding Pattern % (Sep, 2021)	
Promoters	-
Institutions	77.9
Non Institutions	22.1
Total	100.0



HDFCsec Retail research
stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

In the past couple of quarters, MCX has been facing many headwinds due to Covid-19 lockdown, crude volatility impact, subdued trend in Gold prices and SEBI's new margin rules. However, we feel that worst in terms of volume growth decline is over and long term story still remains intact. After four consecutive quarters of ADTV decline, the volume growth on the exchange has started stabilizing. As time passes we believe that the impact of peak upfront margin requirement will start fading off and aided by lower base we could see a decent growth in volumes. MCX has a near monopoly in commodity exchange business with ~92.6% market share as on Q2FY22. The company has been constantly trying to add new products into its basket. TMT bar contracts, electricity futures contract and Natural gas options are expected to launch in current fiscal only. Option volume has been rising significantly and the company has decided to start charging transaction fees effective from 1st October, 2021, which could aid the revenues. The shift to the new trading platform will result in cost savings, leading to a ~260bps margin tailwind in FY23E. Implementation of cross margin rules for index futures will reduce the cost of trading and boost liquidity in such products. Active Unique Client Code (UCC) is on uptrend, indicating higher retail participation. Volume growth from algo channel is also inching up. Permission to domestic financial institutions to participate in commodity markets and launch of futures on indices are major milestones in the long term growth story of commodity exchanges as they have huge potential.

A committee constituted by SEBI has reportedly reached a unanimous decision to let foreign portfolio investors invest in listed futures contracts of 'non-sensitive commodities'. However, a final decision to allow offshore portfolio managers to trade on commodity exchanges would depend on the stand taken by SEBI and the Centre after weighing impact of the proposed reform on prices, particularly that of agricultural commodities. As and when this proposal is implemented, MCX could be one of the key beneficiaries.

Earlier, we had issued initiating coverage report and stock update report on MCX; both base case and bull case target prices for both reports were achieved well within our investment horizon. On account of valuation discount compared to its peers (other listed platform businesses) and growth opportunities we are once again issuing stock update note, revising the targets.

Link for the Reports:

<https://www.hdfcsec.com/hsl.research.pdf/MCX%20-%20Initiating%20Coverage%20-%2014092020.pdf>

https://www.hdfcsec.com/hsl.research.pdf/HSL_Stock%20update%20MCX%20Ltd%20-%2004102021.pdf



Valuation & Recommendation:

MCX has posted weak Q2FY22 numbers due to implementation of peak margin norms. However, we feel that volumes will start to improve going ahead. Volume recovery from the future segment and option volume growth trend, post the exchange has started charging transaction fees, will be the key things to watch out. We estimate 13% futures Average Daily Turnover (ADTV) CAGR over FY21-24E. A high quality monopoly exchange with high structural growth and cyclical resilience deserve higher multiple. The company has high dividend pay-out ratio and we expect a dividend yield of 3.4% for FY24. Currently, the exchanges and depository stocks (platform companies) have become street favourites and are fetching high multiples. We feel that MCX is still available at cheaper valuation compared to other such companies. MCX currently trades at 45.3x FY22E and 29.3x FY23E EPS.

Detailed SOTP calculation is shown in below table. We believe that investors can buy MCX at LTP of Rs. 1758 (27.5xCore EPS of Sep-23+ Cash) and add more at Rs.1591 (24.3xCore EPS of Sep-23+ Cash) for the base case fair value of Rs.1950 (31.2xCore EPS of Sep-23+ Cash) and for the bull case fair value of Rs.2070 (33.5xCore EPS of Sep-23 + Cash) over the next two quarters.

Financial Summary

Particulars (Rs mn)	Q2 FY22	Q2 FY21	YoY (%)	Q1FY22	QoQ (%)	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	832	1,197	(30.5)	876	(5.0)	3,978	3,906	3,814	5,078	6,370
EBITDA	338	657	(48.5)	369	(8.3)	1,784	1,852	1,729	2,957	4,132
APAT	327	586	(44.2)	398	(17.9)	2,365	2,252	1,975	3,067	4,034
Diluted EPS (Rs)	6.4	11.5	(44.2)	7.8	(17.9)	46.5	44.3	38.8	60.3	79.3
P/E (x)						37.8	39.7	45.3	29.2	22.2
EV / EBITDA (x)						40.4	38.5	40.7	23.6	16.6
RoE (%)						18.1	16.2	13.7	20.6	25.7

(Source: Company, HDFC sec)

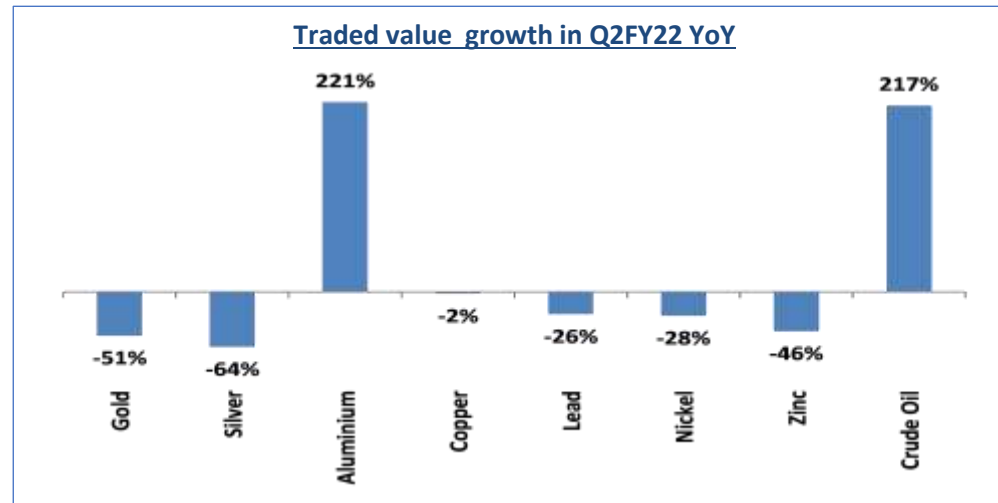
Recent Developments

Q2FY22 Result Update

MCX reported weak Q2FY22 numbers due to peak margin norms. Revenue was down by 30% YoY and 5% QoQ to Rs.832 mn. EBITDA margin stood at 40.6%, down 144bps QoQ, on account of declining revenue. Net profit dipped 44.2% YoY and 18% QoQ because of lower margins and other income. The company has started shifting its investments from tax free bonds to ultra-short term funds. This has impacted the other income during the quarter under review.



The total traded value was at Rs.16.83trn (-5.1/-33.0% QoQ/YoY). ADTV declined sequentially for the fourth consecutive quarter (-8.0/-33.0% QoQ/YoY). Bullion/metals/agri ADTV was down -21.6/-18.0/-31.8 QoQ, while energy ADTV increased by +22.3% YoY. Active UCC was up 7/62% QoQ/YoY, indicating higher retail participation. MCX's market share in the commodity futures market stood at 92.6%. Average daily notional turnover of option contracts was increased by 422% to Rs.60.23 bn in Q2FY22 from Rs.11.53 bn in Q2FY21.



Shift to the new trading platform will drive higher margin

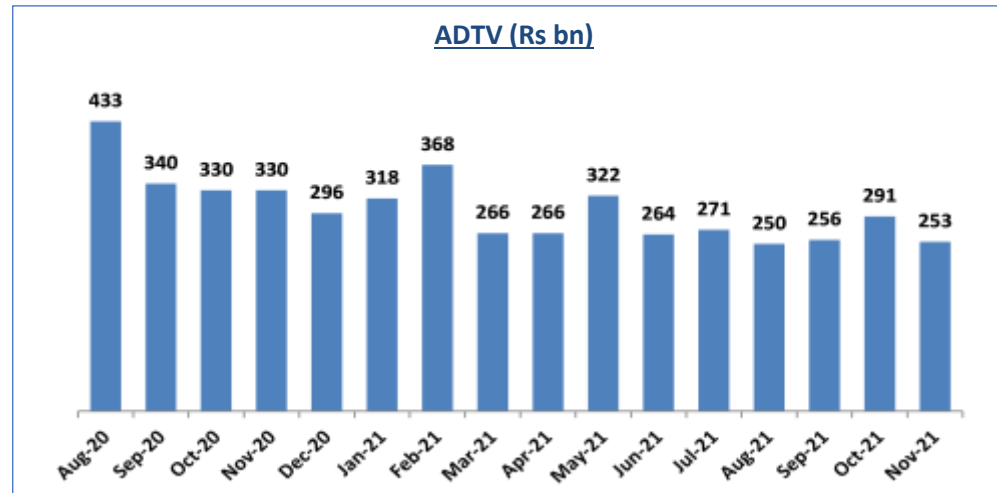
As stated in our last stock update report, the company has tied up with TCS for developing new software, which was expected to go live from September 2022. The shift to the new trading platform could result in cost savings, leading to a ~260bps margin tailwind in FY23E. Currently, technology costs are at 14-15% of transaction revenues.

Worst impact of new margin rules is behind us

SEBI's new margin rules have impacted the volumes of the company significantly. To ensure smooth transit, implementation was done in four phases with rising margin requirements. It started with 25% margin in December 2020 to peak margin (fourth and the last stage) of 100% in September 2021. Q2FY22 was the fourth consecutive quarter of declining ADTV sequentially (-8% QoQ). Trading volume was down 5.1% QoQ due to continued weakness in bullion (-19% QoQ) and decline in metals (-16% QoQ). Now that the peak margin rule has been implemented, things could start normalising and traders will ultimately get used to it. As time passes we believe that the impact will start fading off and aided by lower base we could see a decent growth in volumes. Management has also informed that they are observing a recovery in volumes in Oct-21. ADTV in Oct-21 was at Rs.291 bn compared to Rs.258 bn in Q2FY22.



Nov'21 futures' ADTV stood at Rs253bn, down 13% MoM, led by dip in natural gas' ADTV by 45% (39% in volumes, 10% in price) to Rs39bn. Crude ADTV grew 4.3% MoM. Base metals too remained weak with 21-39% slump for Aluminium, Lead, Nickel and Zinc and 11% for copper MoM. Gold / silver futures' ADTV increased 13.5% / 3.3% MoM. MCX options' ADTV has seen good traction despite transaction charges levied by the company Oct'21 onward. MCX options' ADTV in Nov'21 was Rs98bn, up 14% MoM driven by 103% MoM increase in gold ADTV to Rs13bn. Crude has maintained a dominant portion (84%) of options ADTV and the same rose 6% MoM in Nov'21. MCX index futures volumes witnessed mixed trend with 11% MoM increase in bullion, but 27% MoM decline in metal indices in Nov'21 (all in terms of ADTV).The future ADTV growth in the crude oil is the key concern; it remains at ~Rs.45bn compared to pre-covid average of Rs.130bn. However, the important point to note here is that crude oil ATDV in option category has been growing steadily and now the volumes are rising for gold. Total ADTV in options has now increased to Rs.97.7 bn (in Nov-21) from just Rs.14.8 bn in Apr-21.

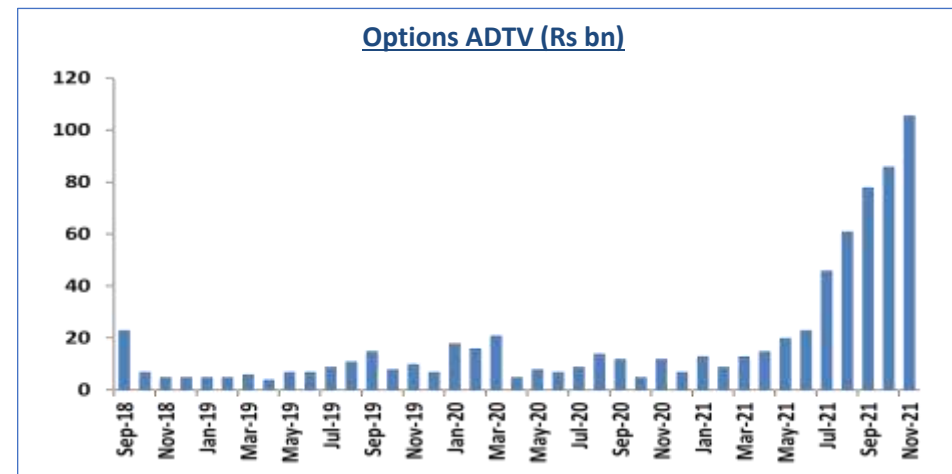


New launches update

The company has been constantly adding new products into its portfolio. In FY21, MCX had launched new categories such as Options in Goods and Commodity Indices. It has also done Memorandum of Understanding with Mjunction Services Ltd to form a joint venture for running a coal exchange. Index futures has started showing traction; Oct-21 turnover was Rs.5bn. Now the company has planned to launch electricity futures contract which will be settled on IEX prices. For that it has to share 10% revenue for two years with IEX. The product is expected to be onboard from current financial year only subject to regulatory approvals. Marketing for the same has already been started. Management has also informed that they are expecting two more products in FY22 only- TMT bar contracts and Natural gas options. Further, they are also evaluating and exploring options for spot gold exchange.



Recently, the volume growth in the option segment has increased significantly (ADTV of Rs.60bn, +217% QoQ) so the company has decided to start charging for these options contracts effective from 1st October, 2021. They will charge Rs.50 per Rs.1 lakh (up to Rs.50 mn and if it exceeds beyond that it will be Rs.40) of the premium value. Options monetization is around 1/3rd of futures meaning 1/3rd of options ADT is equivalent to futures ADT for the purpose of transaction fee. The majority of options volumes are from Crude Oil. Even after they have started charging for option contracts the volume growth remained healthy (10% MoM in Oct-21 and 22.7% MoM in Nov-21). We remain watchful on the option volume growth as significant revenue could be generated from this segment and it could also offset the volume decline trend from the future contracts.



Risks & Concerns

- Any adverse change in regulations could hurt the business in major way.
- High competition from other exchanges, especially after permitting of trading of commodity derivatives on NSE/BSE.
- The possibility of third wave and fresh lock downs could hurt the business as volumes are closely linked with economic conditions both the domestic and the global.
- As the Exchange's transaction fee is calculated on the basis of the value of commodity futures contracts traded on the Exchange, the volume and value of contracts traded on it have a direct impact on MCX's revenues. Falling prices of base metals and bullion could impact its revenues adversely.
- This business has inherent risk of volatility. Market volatility (especially downward) has high correlation with volumes growth. So any prolonged period of negative returns from commodities market can hurt company's revenues hard.



- High dependence on few commodities; gold, silver, crude oil, zinc and copper account for close to 70% of volumes
- Slowdown in the Indian economy and prolonged stress at the corporate level, could impact trade volumes/values
- Regulatory headwinds, such as the ban on trading in certain commodities, higher margin/CTT, or delay in implementing expected policy measures

Company Background:

Having commenced operations on November 10, 2003, Multi Commodity Exchange of India Limited (MCX) is India’s first listed, national-level, electronic exchange. It is also the first exchange to introduce commodity options in India. The market share of MCX stood at 92% in commodity futures segment. MCX offers the benefits of fair price discovery and price risk management to the Indian commodity market ecosystem. Various commodities across segments are traded on the Exchange platform. These include bullion, energy, metals and agri commodities. The exchange has forged strategic alliances with various international exchanges, as well as Indian and international trade associations.

The Company has a national reach with 620 members, having 48,427 Authorised Persons, operating through 42.5 lakh terminals connected through various available modes of connectivity (including Computer to Computer Link (CTCL), Internet Based Trading and Wireless Trading) across 1,000 cities/towns across India. Unique Client Code (UCC) is 69.86 lakh.

Peer comparisons

Company	MCap (Rs bn)	CMP (Rs)	P/E (x)			Dividend Yield (%)			RoE (%)		
			FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
MCX	89.6	1,758	39.7	45.3	29.2	1.9	1.7	2.6	16.2	13.7	20.6
BSE	100.8	2,239	57.5	40.1	33.3	0.9	1.6	2.0	7	9.8	11.5
CDSL	171.3	1,639	87.7	61.0	50.8	0.6	0.6	0.7	22.8	27.8	27.9

SOTP Valuations:

	Base Case	Bull Case
Core PAT Sep-23 (Rs mn)	2,647	2,647
Core P/E Multiple (x)	31.2	33.5
Core Mcap (Rs mn)	82,586	88,675
Add: Net Cash (Rsmn) ex SGF	16,646	16,646
Target Mcap (Rs mn)	99,233	1,05,321
Target Price (Rs)	1,950	2,070



Multi Commodity Exchange of India Ltd.

Financials

Income Statement

(Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	3,978	3,906	3,814	5,078	6,370
Growth (%)	32.6	(1.8)	(2.3)	33.1	25.5
Software support charges	689	636	635	525	500
Employee Expenses	773	751	829	921	1,022
Tech & SG&A Expenses	206	211	211	232	250
Other Operating Expenses	526	456	410	443	465
EBITDA	1,784	1,852	1,729	2,957	4,132
EBITDA Margin (%)	44.8	47.4	45.3	58.2	64.9
EBITDA Growth (%)	89.9	3.8	(6.6)	71.0	39.7
Depreciation	182	221	243	268	365
EBIT	1,602	1,632	1,486	2,689	3,767
Other Income (Including EO Items)	1,053	1,038	924	1,053	1,155
Interest	2	3	3	3	3
PBT	2,653	2,667	2,407	3,739	4,919
Tax (Incl Deferred)	289	415	433	673	885
Minority Interest & Associate profit	0.4	0.9	0.9	0.9	0.9
APAT	2,365	2,252	1,975	3,067	4,034
APAT Growth (%)	39.1	(4.8)	(12.3)	55.3	31.6
Core PAT (ex other income)	1,428	1,377	1,219	2,205	3,089
Core PAT Growth (%)	91.2	(3.5)	(11.5)	80.9	40.1
Adjusted EPS (Rs)	46.5	44.3	38.8	60.3	79.3
EPS Growth (%)	39.1	(4.8)	(12.3)	55.3	31.6

Balance Sheet

(Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
SOURCES OF FUNDS					
Share Capital - Equity	510	510	510	510	510
Reserves	13,084	13,672	14,072	14,743	15,654
Total Shareholders' Funds	13,594	14,182	14,582	15,253	16,164
Settlement guarantee fund	4,098	4,692	4,786	4,882	4,980
Net Deferred Taxes (Net)	18	22	22	22	22
Long Term Provisions & Others	528	554	554	554	554
TOTAL SOURCES OF FUNDS	18,237	19,451	19,944	20,711	21,719
APPLICATION OF FUNDS					
Net Block	1,583	1,594	1,580	1,616	1,634
CWIP	237	263	263	263	263
Investments	123	124	124	124	124
LT Loans & Advances	708	667	701	736	773
Total Non-current Assets	2,651	2,649	2,668	2,740	2,794
Debtors	65	90	63	83	105
Other Current Assets	753	948	731	974	1,222
Cash & Equivalent	23,878	21,339	22,136	24,273	26,728
Total Current Assets	24,695	22,377	22,930	25,330	28,055
Trading margin from members	7,599	4,175	4,044	5,507	7,000
Other Current Liabilities & Provns	1,510	1,400	1,610	1,851	2,129
Total Current Liabilities	9,109	5,575	5,654	7,359	9,129
Net Current Assets	15,586	16,802	17,276	17,971	18,926
TOTAL APPLICATION OF FUNDS	18,237	19,451	19,944	20,711	21,719

(Source: Company, HDFC sec)



Multi Commodity Exchange of India Ltd.

Cash Flow Statement

(Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Reported PBT	2,653	2,667	2,407	3,739	4,919
Non-operating & EO items	(1,224)	(981)	(924)	(1,053)	(1,155)
Interest expenses	2	2	3	3	3
Depreciation	181	221	243	268	365
Working Capital Change	3,402	(3,274)	291	1,407	1,465
Tax Paid	(523)	(479)	(433)	(673)	(885)
OPERATING CASH FLOW (a)	4,492	(1,844)	1,587	3,691	4,711
Capex	(277)	(211)	(229)	(305)	(382)
Free cash flow (FCF)	4,215	(2,055)	1,358	3,387	4,329
Investments	0	0	0	0	0
Non-operating Income	407	302	924	1,053	1,155
INVESTING CASH FLOW (b)	130	91	695	748	773
Debt Issuance/(Repaid)	0	0	0	0	0
Interest Expenses	0	(0)	(3)	(3)	(3)
FCFE	4,215	(2,055)	1,355	3,384	4,326
Share Capital Issuance	0	0	0	0	0
Dividend	(1,230)	(1,530)	(1,481)	(2,300)	(3,026)
FINANCING CASH FLOW (c)	(1,230)	(1,530)	(1,484)	(2,303)	(3,029)
NET CASH FLOW (a+b+c)	3,392	(3,284)	798	2,136	2,455
EO Items, Others	3,243	744	0	0	0
Closing Cash & Equivalents	23,878	21,339	22,136	24,273	26,728

Key Ratios

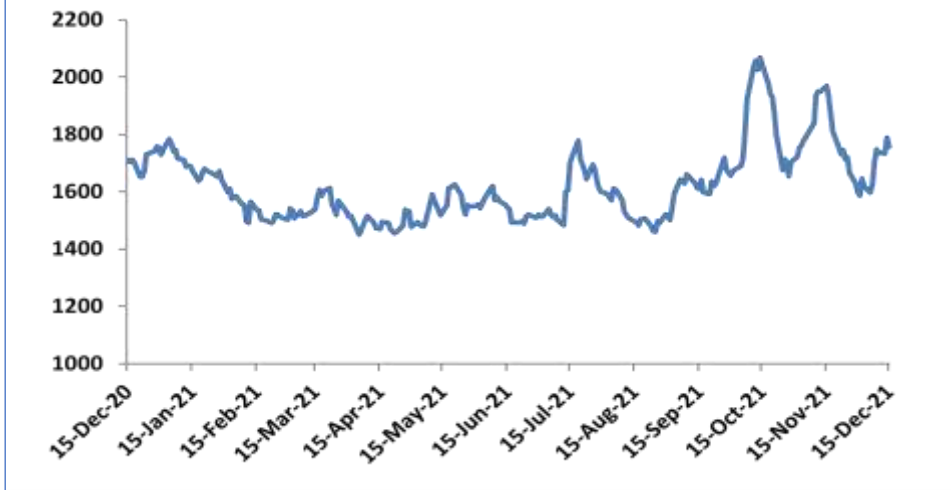
	FY20	FY21	FY22E	FY23E	FY24E
PROFITABILITY (%)					
GPM	82.7	83.7	83.4	89.7	92.2
EBITDA Margin	44.8	47.4	45.3	58.2	64.9
APAT Margin	59.4	57.7	51.8	60.4	63.3
RoE	18.1	16.2	13.7	20.6	25.7
RoIC (or Core RoCE)	25.4	23.4	21.0	31.5	40.1
RoCE	13.7	12.0	10.0	14.4	18.5
EFFICIENCY					
Tax Rate (%)	10.9	15.6	18.0	18.0	18.0
Fixed Asset Turnover (x)	0.1	0.2	0.1	0.2	0.2
Debtors (days)	6	8	6	6	6
Other Current Assets (days)	69	89	70	70	70
Other Current Liab & Provns (days)	388	392	468	563	639
Cash Conversion Cycle (days)	-313	-295	-392	-487	-563
Net D/E (x)	-1	-1	-1	-1	-1
PER SHARE DATA (Rs)					
EPS	46.5	44.3	38.8	60.3	79.3
CEPS	50.0	48.6	43.6	65.5	86.4
Dividend	30.0	33.2	29.1	45.2	59.4
Book Value	267.1	278.6	286.5	299.7	317.6
VALUATION					
P/E (x)	37.8	39.7	45.3	29.2	22.2
P/BV (x)	6.6	6.3	6.1	5.9	5.5
EV/EBITDA (x)	40.4	38.5	40.7	23.6	16.6
Dividend Yield (%)	1.7	1.9	1.7	2.6	3.4

(Source: Company, HDFC sec)



Multi Commodity Exchange of India Ltd.

One Year Price Chart





Multi Commodity Exchange of India Ltd.



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicity of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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Mutual Funds Investments are subject to market risk. Please read the offer and scheme related documents carefully before investing.