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20
YEARS

Initiating Coverage Multi Commodity Exchange Limited

14-September-2020



Multi Commodity Exchange Ltd.

| Industry | LTP | Recommendation | Base Case Fair Value | Bull Case Fair Value | Time Horizon |
|--------------------|------------|---|----------------------|----------------------|--------------|
| Commodity Exchange | Rs.1554.85 | Buy at LTP and add on dips to Rs.1375-1385 band | Rs.1729 | Rs.1839 | 2 quarters |

| | |
|---------------------|------------|
| HDFC Scrip Code | MCXLTDEQNR |
| BSE Code | 534091 |
| NSE Code | MCX |
| Bloomberg | MCX |
| CMP Sep 11, 2020 | 1554.85 |
| Equity Capital (mn) | 510 |
| Face Value (Rs) | 10 |
| Eq- Share O/S(mn) | 51 |
| Market Cap (Rsmn) | 79297 |
| Book Value (Rs) | 267 |
| Avg.52 Wk Volume | 690527 |
| 52 Week High | 1838.5 |
| 52 Week Low | 805.1 |

| Share holding Pattern % (Jun, 2020) | |
|-------------------------------------|-------|
| Promoters | - |
| Institutions | 77.51 |
| Non Institutions | 22.49 |
| Total | 100.0 |

Fundamental Research Analyst

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Our Take:

MCX has a near monopoly in commodity exchange business with ~96.7% market share as on Q1FY21. In the long term, we expect conducive regulatory environment along with index future launch to boost Institutional participation, resulting in higher trading volumes and improvement in market depth. Globally, Institutional clients account for ~50% of the total derivatives volumes which provide good visibility of future growth. Strong recovery in ADTV (Average Daily Trading Volume) and the volatility in commodities prices globally are the key near term positives for the company. We believe, MCX with its inherent strength of asset light business model along with minimal capex requirement, consistent FCF generation and cash-rich balance sheet (ex-Settlement guarantee fund cash is Rs.19780 mn ~25% of Mcap) would allow it to navigate through the current Covid-19 crisis with minimal impact.

Valuations & Recommendation:

We expect MCX to post 28% EBITDA CAGR, driven by revenue CAGR of 15% for FY20-22E. Net profit is envisaged to grow by 10% CAGR over same time frame. EBITDA margin is estimated to reach to 50.7% in FY22E vs 41.4% in FY20. We expect volume to decline in FY21E with recovery in FY22E led by bullion and metals. Considering the asset-light nature of the business, we expect RoE to recover to 19.9% in FY22E vs 17.8% in FY20. MCX currently trades at 33.1x FY21E and 28.4x FY22E EPS.

We assign a P/E multiple of 39.5x for bull case fair value and 36.5x for base case fair value to core earnings and add back net cash to arrive at a SoTP based price of Rs.1839 for bull case fair value and Rs.1729 for base case fair value. **We feel that investors can buy the stock at the LTP and on dips to Rs.1375-1385 band (27.0xCore EPS + Cash). At the current price of Rs.1554.85, it quotes at 31.8xCore earnings + Cash.**

Financial Summary

| Particulars (Rs bn) | Q1FY21 | Q1FY20 | YoY-% | Q4FY20 | QoQ-% | FY19 | FY20 | FY21E | FY22E |
|---------------------|--------|--------|-------|--------|-------|------|------|-------|-------|
| Net Revenues | 0.73 | 0.79 | -8.1 | 1.05 | -30.7 | 3 | 3.74 | 4.15 | 4.95 |
| EBITDA | 0.27 | 0.28 | -4.3 | 0.41 | -34.9 | 0.94 | 1.55 | 1.93 | 2.53 |
| APAT | 0.56 | 0.44 | 29.1 | 0.66 | -13.8 | 1.7 | 2.33 | 2.39 | 2.81 |
| Diluted EPS (Rs) | 11.1 | 8.6 | 29.1 | 12.9 | -13.8 | 33.4 | 45.7 | 47 | 55.3 |
| P/E (x) | | | | | | 46.5 | 34.0 | 33.1 | 28.4 |
| EV / EBITDA (x) | | | | | | 74.2 | 44.1 | 35.2 | 26.8 |
| RoE (%) | | | | | | 12.9 | 17.8 | 17.3 | 19.9 |

(Source: Company, HDFC sec)

Recent Developments:

Q1FY21 Result Highlights: MCX market share increased to 96.7% (+530bps YoY), which demonstrates the core strength of the franchise. Number of unique client codes rose 15% in Q1FY21 to 3.89 mn over Q4FY20. Both revenue and margin performance was weak in Q1. MCX revenue was down 30.7/8.1% QoQ/YoY. Traded volume was down 41.6/18.5% QoQ/YoY to Rs 14.11tn. Total Average Daily Trading Volume (ADTV) was down 36.9/15.8% QoQ/YoY to Rs 231bn. The bulk of the decline in Q1 was due to Energy (-65.9% QoQ) and Metals (-21.5% QoQ). Bullion was down only 6.6% QoQ in Q1 but is up 87% YoY in July-20. EBITDA margin stood at 38.7%, down 235bps QoQ. ADTV recovery has been strong in the past three months; in Aug-20, it was at Rs 432.62 bn (+23.7% YoY), led by Bullion and Metals. The crude volume is still down due to high margin requirements (~100% vs. ~10% earlier). MCX is planning to launch spot exchanges for Bullion and Natural Gas. Options roll out in gold, crude, copper, silver, zinc has been gradual and lower than expected.

High volatility along with price rise in international Gold and Silver prices have helped company in generating higher revenue and profit recently. Even the future prospects in this segment are also bright because of Covid-19 lead weak global economic scenario, falling interest rates, liquidity injections etc. After strong Q4, volume dropped significantly in April-20. It was down 37% QoQ in Q1 due to the impact of COVID-19, change in exchange timing (April 20) and crude fiasco, which recovered strongly to pre-COVID levels in July-20. Bullion (57% of volume) continues to drive growth (+52% above Q4 level) supported by volatility in precious metal prices. Crude (~25% of volume) is impacted by the high margin requirement (~100%) and extreme volatility.

Long term Triggers

Even after granting permission to Bombay Stock Exchange of India (BSE) and the National Stock Exchange of India (NSE) in the commodity derivatives space, the industry has a near monopoly situation with ~94% market share being held by MCX as of March 2020. NCDEX is a distant peer with ~4.95% in market share in FY20. It's difficult to shift volume from existing exchange based on pricing. Depth, liquidity and impact cost are the most critical factors. MCX is a market leader in base metals, energy and precious metals and stones segments (having more than 98% market share in some segments). But in agriculture commodities, MCX has market share of just 17% as of March 2020.

There have been a number of changes made in the recent times that have been very healthy for the market, and augurs well for MCX. Permission to domestic financial institutions to participate in commodity markets was one of the significant measures. Alternative Investment Funds – Category III (AIF-Cat III) was the first category of domestic financial institutions to receive such permission and SEBI has recently allowed participation of Mutual Funds and Portfolio Managers in the commodity derivative markets which is very beneficial for the future growth of the industry. However, even after a year of approval, the participation of institutional investors has remained low. The entry of institutional participants can spur retail participation and ease the access of small stakeholders, including the hedgers, to the hedging and investment platform of commodity exchanges. Globally Institutions account for ~50% of the total derivatives volume.

The Exchange has also received permission from SEBI for futures on indices like iComdex Bullion (for precious metals like Gold and Silver) and iComdex Base Metals (five metals – copper, aluminum, lead, nickel and zinc). MCX on Aug 24 launched futures trading on the country's first tradeable real-time bullion index, MCX iCOMDEX Bullion. The index futures will be cash settled, unlike its individual constituents which have to be settled by delivery. Because of its nature, this index will attract many participants, including for Mutual Funds, AIF, FIs etc.

MCX is planning more products in the energy segment and continues to forge new industry tie-ups, such as that with Mjunction. Mutual funds have launched schemes including commodities. One of the key action plans for most retail equity bank-backed brokers is to increase retail commodity participation. All these could result in structural revenue growth for MCX.

Because of asset light business model and minimal capex requirement, the balance sheet of the company is robust. As of FY20, the net cash on the books (ex-Settlement guarantee fund) is Rs.19780 mn (~25% of Mcap). It has also a very healthy dividend pay-out ratio of ~80%. The company earned an excellent EBITDA margin of around 41% in FY20.

What could go wrong:

- **Falling prices yielding declining contract values:** 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.
- **Technology vulnerability:** One of the most significant enablers for MCX to experience high inclusive growth has been technology. The successful operations of MCX's business and operating results are dependent in part on the use and deployment of technology. However, technology is susceptible to obsolescence, and increasingly, to cyber-attacks from across the globe. MCX needs to be at the cutting edge of technological infrastructure and connectivity, meeting the ever-evolving demands of its stakeholders with safe and multiple choices of connectivity as per the participant needs. Thus, maintenance of such technology is the highest priority for company's business.
- **Macro-economic Trends:** India's commodity derivatives market is impacted by both the domestic and the global economic conditions. Thus, as a part of the Indian commodity derivatives market, the result of MCX's operation is significantly impacted by these economic conditions. The demand and supply of commodities is driven by the growth in the economy, which in turn affects the overall volume of commodities being traded in India.
- **Enhanced pressure from competition:** SEBI has approved a proposal to permit trading of commodity derivatives and other segments of securities market on a single exchange. This has brought in competition from NSE/BSE in the commodity market and a potential area of risk to MCX.
- **Adverse regulatory and policy decisions:** All aspects of MCX's operations are subject to regulatory oversights. Changes in laws, regulations, taxation etc., or new rules, regulations or policies may necessitate MCX to allocate more resources for compliance. This may impede the Company's ability to operate and grow its business or may affect the economic prospects for market intermediation. Some policies or regulations may also have adverse repercussions on the Exchange's business.

About the company

Multi Commodity Exchange of India (MCX) is a leading commodities exchange based on value of commodity futures contracts traded in India. The company is a de-mutualised exchange and received permanent recognition from the Government of India on September 26, 2003, to facilitate nationwide online trading, clearing and settlement operations of commodities futures transactions. MCX offers trading in varied commodity futures contracts across segments including bullion, industrial metals, energy and agricultural commodities. The Exchange focuses on providing commodity value chain participants with neutral, secure and transparent trade mechanisms, and formulates quality parameters and trade regulations, in conformity with the regulatory framework. The Exchange has an extensive national reach, with 692 registered members and 54,900 Authorised Persons with its presence in around 1010 cities and towns across India as on 31 March 2020. MCX is India's leading commodity derivatives exchange with a market share of 94.01% per cent in terms of the value of commodity futures contracts traded in FY20.

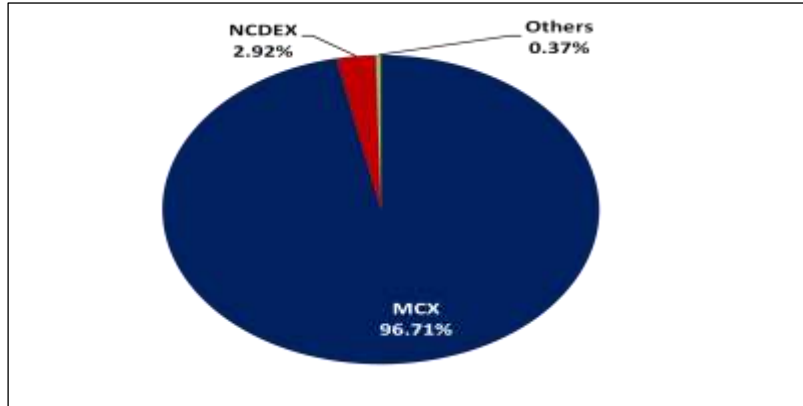
SOTP Valuations:

| | Base Case | Bull Case |
|-----------------------------|--------------|--------------|
| Core PAT FY22E (Rs mn) | 1,874 | 1,874 |
| Core P/E Multiple (x) | 36.5 | 39.5 |
| Core Mcap (Rs mn) | 68,401 | 74,023 |
| Add: Net Cash (Rsmn) ex SGF | 19,780 | 19,780 |
| Target Mcap (Rs mn) | 88,181 | 93,803 |
| Target Price (Rs) | 1,729 | 1,839 |

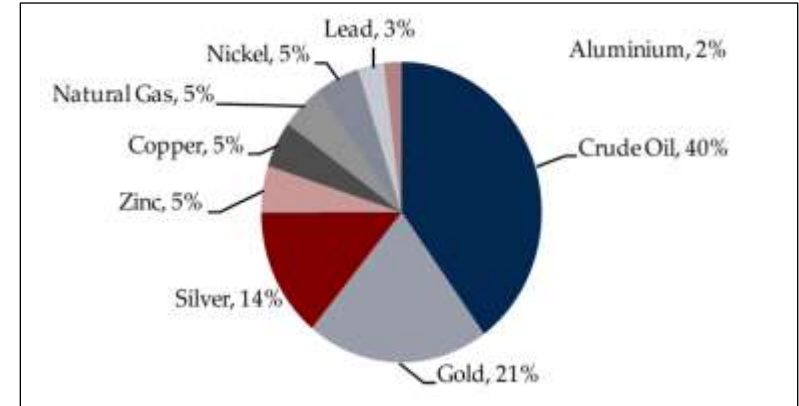
Peer Comparison:

| Company | MCap (Rs bn) | CMP (Rs) | P/E (x) | | | Dividend Yield (%) | | | RoE (%) | | |
|---------|-----------------|----------|---------|-------|-------|--------------------|-------|-------|---------|-------|-------|
| | | | FY20 | FY21E | FY22E | FY20 | FY21E | FY22E | FY20 | FY21E | FY22E |
| MCX | 79.3 | 1,554 | 34 | 33 | 28.4 | 1.9 | 2.1 | 2.5 | 17.8 | 17.3 | 19.7 |
| BSE | 23.9 | 530 | 16.9 | 14.6 | 11.9 | 3.2 | 5 | 6.3 | 5.8 | 6.9 | 8.1 |
| CDSL | 46.8 | 448 | 37.3 | 31.6 | 28 | 1 | 1 | 1.1 | 18.4 | 18.6 | 18.4 |

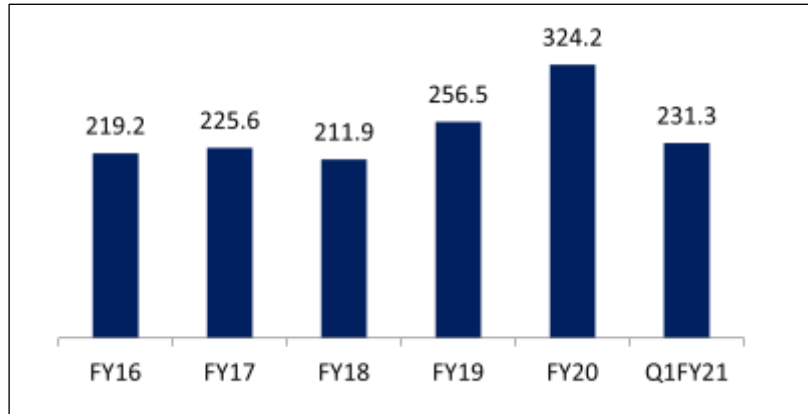
Commodity Derivatives Market Share Q1FY21



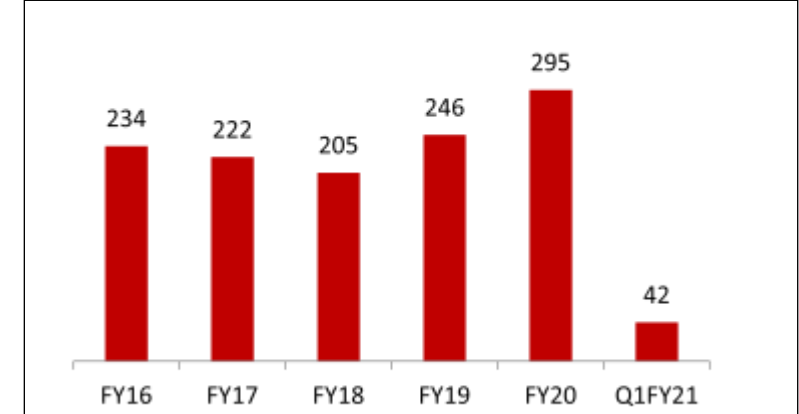
Mix Of Major Traded Commodities On MCX



Average Daily Turnover (Rs bn)



Volume of Contracts (Lots in mn)



(Source: Company, HDFC sec)

Multi Commodity Exchange Ltd.

Financials

Income Statement

| (Rs mn) | FY18 | FY19 | FY20 | FY21E | FY22E |
|--------------------------------------|--------|-------|-------|-------|-------|
| Net Revenues | 2,598 | 3,000 | 3,742 | 4,145 | 4,914 |
| Growth (%) | 0.2 | 15.5 | 24.7 | 10.8 | 18.5 |
| Software support charges | 494 | 614 | 689 | 677 | 788 |
| Employee Expenses | 682 | 725 | 773 | 777 | 834 |
| Tech & SG&A Expenses | 229 | 205 | 206 | 216 | 227 |
| Other Operating Expenses | 474 | 517 | 524 | 540 | 572 |
| EBITDA | 719 | 940 | 1,549 | 1,935 | 2,493 |
| EBITDA Margin (%) | 27.7 | 31.3 | 41.4 | 46.7 | 50.7 |
| Depreciation | 167 | 154 | 182 | 195 | 207 |
| EBIT | 552 | 785 | 1,367 | 1,740 | 2,286 |
| Other Income (Including EO Items) | 920 | 748 | 1,289 | 1,174 | 1,114 |
| Interest | 0 | 0 | 3 | 3 | 3 |
| PBT | 1,472 | 1,533 | 2,654 | 2,911 | 3,397 |
| Tax (Incl Deferred) | 388 | 75 | 329 | 524 | 611 |
| Minority Interest & Associate profit | 0 | 4.3 | 0.4 | 0.4 | 0.4 |
| RPAT | 1,084 | 1,462 | 2,325 | 2,387 | 2,786 |
| EO (Loss) / Profit (Net Of Tax) | 0 | -238 | 0 | 0 | 0 |
| APAT | 1,084 | 1,700 | 2,325 | 2,387 | 2,786 |
| APAT Growth (%) | (14.4) | 56.9 | 36.8 | 2.7 | 16.7 |
| Core PAT (ex other income) | 406 | 747 | 1,198 | 1,427 | 1,874 |
| Adjusted EPS (Rs) | 21.3 | 33.4 | 45.7 | 47.0 | 54.8 |
| EPS Growth (%) | (14.4) | 56.9 | 36.8 | 2.7 | 16.7 |

Balance Sheet

| As at March (Rs mn) | FY18 | FY19 | FY20 | FY21E | FY22E |
|------------------------------------|---------------|---------------|---------------|---------------|---------------|
| SOURCES OF FUNDS | | | | | |
| Share Capital - Equity | 510 | 510 | 510 | 510 | 510 |
| Reserves | 13,295 | 11,999 | 13,084 | 13,434 | 13,855 |
| Total Shareholders Funds | 13,805 | 12,509 | 13,594 | 13,944 | 14,365 |
| Settlement guarantee fund | 1,806 | 3,298 | 4,098 | 4,180 | 4,263 |
| Net Deferred Taxes (Net) | 172 | 14 | 18 | 18 | 18 |
| Long Term Provisions & Others | 238 | 401 | 528 | 528 | 528 |
| TOTAL SOURCES OF FUNDS | 16,021 | 16,221 | 18,237 | 18,669 | 19,174 |
| APPLICATION OF FUNDS | | | | | |
| Net Block | 1,562 | 1,580 | 1,583 | 1,679 | 1,767 |
| CWIP | 55 | 190 | 237 | 237 | 237 |
| Investments | 0 | 123 | 123 | 123 | 123 |
| LT Loans & Advances | 339 | 614 | 708 | 672 | 706 |
| Total Non-current Assets | 1,957 | 2,506 | 2,651 | 2,711 | 2,832 |
| Debtors | 63 | 60 | 65 | 80 | 81 |
| Other Current Assets | 862 | 945 | 753 | 852 | 942 |
| Cash & Equivalents | 16,782 | 17,243 | 23,878 | 24,380 | 24,991 |
| Total Current Assets | 17,706 | 18,248 | 24,695 | 25,311 | 26,015 |
| Trading margin from members | 2,789 | 3,518 | 7,599 | 7,994 | 8,110 |
| Other Current Liabilities & Provns | 853 | 1,016 | 1,510 | 1,359 | 1,563 |
| Total Current Liabilities | 3,642 | 4,533 | 9,109 | 9,353 | 9,673 |
| Net Current Assets | 14,064 | 13,715 | 15,586 | 15,959 | 16,341 |
| TOTAL APPLICATION OF FUNDS | 16,021 | 16,221 | 18,237 | 18,669 | 19,174 |

Multi Commodity Exchange Ltd.

Cash Flow Statement

| (Rs mn) | FY18 | FY19 | FY20 | FY21E | FY22E |
|----------------------------------|--------------|----------------|----------------|----------------|----------------|
| Reported PBT | 1,472 | 1,533 | 2,654 | 2,911 | 3,397 |
| Non-operating & EO items | (910) | (954) | (1,224) | (1,174) | (1,114) |
| Interest expenses | 0 | 0 | 2 | 3 | 3 |
| Depreciation | 167 | 155 | 181 | 195 | 207 |
| Working Capital Change | 561 | 2,153 | 3,402 | 166 | 195 |
| Tax Paid | (296) | (295) | (523) | (524) | (611) |
| OPERATING CASH FLOW (a) | 993 | 2,591 | 4,492 | 1,576 | 2,077 |
| Capex | (266) | (271) | (255) | (290) | (295) |
| <i>Free cash flow (FCF)</i> | <i>727</i> | <i>2,320</i> | <i>4,237</i> | <i>1,286</i> | <i>1,782</i> |
| Non-operating Income | 525 | 445 | 407 | 1,174 | 1,114 |
| INVESTING CASH FLOW (b) | 259 | 174 | 152 | 884 | 819 |
| Interest Expenses | (0) | (0) | 0 | (3) | (3) |
| <i>FCFE</i> | <i>727</i> | <i>2,320</i> | <i>4,237</i> | <i>1,284</i> | <i>1,779</i> |
| Dividend | (921) | (1,045) | (1,230) | (1,955) | (2,282) |
| FINANCING CASH FLOW (c) | (921) | (1,045) | (1,230) | (1,958) | (2,284) |
| NET CASH FLOW (a+b+c) | 332 | 1,719 | 3,415 | 502 | 611 |
| EO Items, Others | 460 | (1,258) | 3,221 | 0 | 0 |
| Closing Cash & Equivalents | 16,782 | 17,243 | 23,878 | 24,380 | 24,991 |

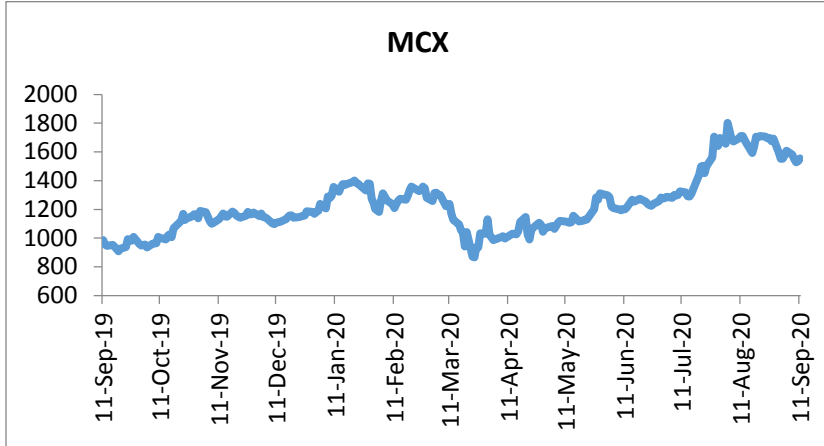
Key Ratios

| | FY18 | FY19 | FY20 | FY21E | FY22E |
|----------------------------|-------|-------|-------|-------|-------|
| PROFITABILITY (%) | | | | | |
| GPM | 81.0 | 79.6 | 81.6 | 83.7 | 84.0 |
| EBITDA Margin | 27.7 | 31.3 | 41.4 | 46.7 | 50.7 |
| APAT Margin | 41.7 | 56.7 | 62.1 | 57.6 | 56.7 |
| RoE | 7.9 | 12.9 | 17.8 | 17.3 | 19.7 |
| RoIC (or Core RoCE) | 15.2 | 17.7 | 25.0 | 25.2 | 28.8 |
| RoCE | 6.8 | 10.5 | 13.5 | 12.9 | 14.7 |
| EFFICIENCY | | | | | |
| Tax Rate (%) | 26.4 | 4.9 | 12.4 | 18.0 | 18.0 |
| Fixed Asset Turnover (x) | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 |
| Net D/E (x) | -1 | -1 | -1 | -1 | -1 |
| PER SHARE DATA (Rs) | | | | | |
| EPS | 21.3 | 33.4 | 45.7 | 47.0 | 54.8 |
| CEPS | 24.6 | 36.5 | 49.3 | 50.8 | 58.9 |
| Dividend | 17.0 | 20.0 | 30.0 | 32.9 | 38.4 |
| Book Value | 271.5 | 246.0 | 267.3 | 274.2 | 282.5 |
| VALUATION | | | | | |
| P/E (x) | 73.0 | 46.5 | 34.0 | 33.1 | 28.4 |
| P/BV (x) | 5.7 | 6.3 | 5.8 | 5.7 | 5.5 |
| EV/EBITDA (x) | 95.9 | 74.2 | 44.1 | 35.2 | 27.1 |
| Dividend Yield (%) | 1.1 | 1.3 | 1.9 | 2.1 | 2.5 |

(Source: Company, HDFC sec Research)



One Year Price Chart



Multi Commodity Exchange Ltd.

Disclosure:

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