

MULTI COMMODITY EXCHANGE

Recommendation		BACKGROUND	
Price Band	Rs 860-Rs 1,032		<p>Background</p> <p>MCX is the leading commodities exchange in India based on value of commodity futures contracts traded. It 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.</p> <p>As of December 31, 2011, MCX offered trading in 49 commodity futures based on contract specifications, from a diverse range of classes including bullion, ferrous and non-ferrous metals, energy and agriculture. As of December 31, 2011, MCX had 2,153 members on the Exchange platform, with over 296,000 terminals including CTCL spread over 1,572 cities and towns across India.</p> <p>MCX is the fifth largest commodity futures exchange globally, among all the commodity exchanges considered in the FIA survey, in terms of the number of contracts traded. Based on the comparison of the trading volumes of MCX with the leading global commodity futures exchanges in the world, for the calendar year 2010 and the six months ended June 30, 2011, MCX was the largest silver exchange, the second largest gold, copper and natural gas exchange and the third largest crude oil exchange for this period. We believe that the leadership position in these products gives MCX a competitive advantage.</p> <p>CRISIL has assigned a 'Grade 5' to the MCX IPO which indicates 'Strong Fundamentals'.</p> <p>The Developed countries Exchanges like CME, CBOT enjoy an EBITDA margin of approximately 60% with a growth of around 9-10%. These exchanges enjoy a P/E of around 17-18x on CY12 earnings. The developing countries also enjoy an EBITDA margin of around 60% with a growth of 10-15% and enjoy a P/E of 24-25x on CY12E. Whereas, MCX being the first exchange in India to be listed is trading at a P/E of 18x on annualized FY12E earnings with a 30% growth. We believe that MCX enjoys a lower multiple as compared to other exchanges even though the growth rate is higher. We believe that the valuations are attractive at current levels.</p> <p>MCX shares is offered at 4.9x P/BV and 18.11x P/E calculated at higher band of price for 9MFY12 annualized EPS. We believe that the leadership position in the commodities industry with minimal competition, MCX will definitely command a premium multiple. Considering promoter's position in the market, visible brand, better operational parameters & diversified portfolio, we expect MCX can command higher premium going ahead. Therefore, we recommend a "SUBSCRIBE".</p> <p>Objects of the Issue</p> <p>Since the Offer is a pure offer for sale, the Company would not receive any proceeds from the Offer. The main object of the issue is to get listed on the exchange.</p>
Bidding Date	22 nd Feb-24 th Feb		
Book Running Lead Manager	Edelweiss Financial Services, Citigroup Global Markets and Morgan Stanley		
Registrar	Karvy Computershare		
Sector	Exchange		
Retail Application- Detail At Cut off Price			
Number of Shares	192		
Application Money	198144		
Amount Payable	198144		
Discount to retail	-		
Financials (Rs in Crs)	FY11	9MFY12	
Total Income	447.6	474.5	
PBT	245.8	312.2	
PAT	173.5	220.7	
Valuations	Lower Band	Upper Band	
Market Cap (Rs in crs)	4385	5262	
EPS*	56.98	56.98	
Book Value*	210.42	210.42	
P/E ratio*	15.09	18.11	
P/BV*	4.09	4.90	
*calculated on diluted equity, 9MFY12 annualised			
Post Issue Shareholding Pattern			
Promoters	26.0%		
Foreign bodies	23.0%		
Institutions	28%		
Corporates	6%		
Public	17.0%		
Offer structure for different categories			
QIB (Including Mutual Fund)	48.1%		
HNI	14.4%		
Retail	33.6%		
Employee Reservation	3.9%		
Post Issue Equity (Rs. in crore)	51.0		
Issue Size (Rs in crs)	553-663		
Face Value (Rs)	10		
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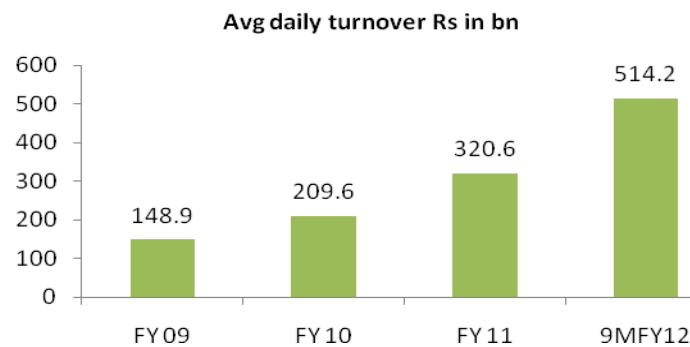


MULTI COMMODITY EXCHANGE

Business

MCX is the leading commodities exchange in India based on value of commodity futures contracts traded. It is a de-metallized 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.

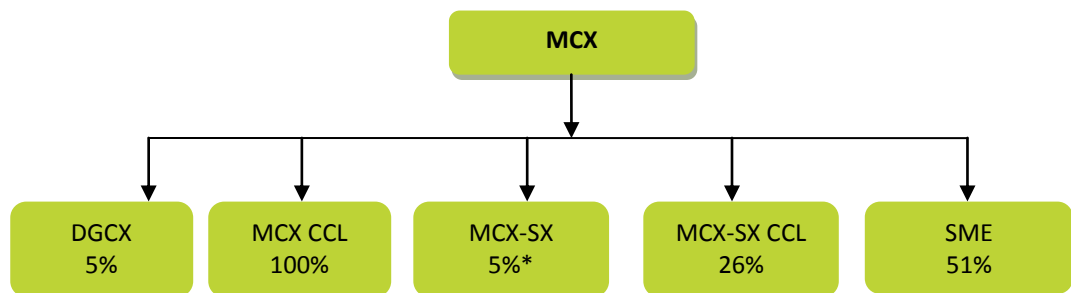
As of December 31, 2011, MCX offered trading in 49 commodity futures based on contract specifications, from a diverse range of classes including bullion, ferrous and non-ferrous metals, energy and agriculture. As of December 31, 2011, MCX had 2,153 members on the Exchange platform, with over 296,000 terminals including CTCL spread over 1,572 cities and towns across India. The CAGR of average daily turnover stood at 47.2% over FY09-FY11.



Source: Company data, Nirmal Bang Securities

The total value of commodity futures contracts traded on the Exchange in the nine months ended December 31, 2011 and FY11, FY10 and FY09 was Rs 119,806.9 bn, Rs 98,415 bn, Rs 63,933 bn and Rs 45,880.9 bn, respectively. According to data maintained by the FMC, these amounts represented 87.3%, 82.4%, 82.3% and 87.4% of the Indian commodity futures industry in terms of the value of commodity futures contracts traded during the same periods.

Its Promoters (Financial Technologies) owns 31.18% of its equity share capital. Its other larger shareholders include financial institutions and other entities from the financial sector, such as FID Funds (Mauritius) Limited (an affiliate of Fidelity International), Euronext N.V. (an affiliate of NYSE Euronext) and Merrill Lynch Holdings (Mauritius).



Source: Company data, Nirmal Bang Securities

MULTI COMMODITY EXCHANGE

- On November 9, 2004, MCX signed a memorandum of understanding with Financial Technologies (India) Limited and the Dubai Metals and Commodities Centre (now known as Dubai Multi Commodity Centre) to establish, as a joint venture, the DGCX. DGCX commenced operations with gold futures trading in November 2005. MCX currently hold 5.0% of the equity share capital of DGCX and the book value of this investment was Rs 21.85 million as of December 31, 2011.
- MCX CCL is 100% subsidiary which was established as a separate clearing house to undertake clearing and settlement of trades and the provision of counterparty risk guarantee on Exchange. MCX CCL has not commenced operations as it is awaiting the approval of FMC.
- MCX-SX was promoted by MCX and its Promoter, FTIL in 2008. However, currently, FTIL does not hold a controlling shareholding in MCX-SX. MCX has reduced its shareholding to 5.0% in MCX-SX pursuant to the Scheme.
- Clearing and settlement functions of MCX-SX are performed by MCX-SX Clearing Corporation Limited (MCXSX CCL). MCX-SX CCL was established to undertake clearing and settlement of trades in multi-asset securities. MCX-SX CCL is the second clearing corporation in India handling clearing and settlement of trades done on stock exchanges pursuant to permission granted by SEBI. As of December 31, 2011, MCX had a direct stake of 26.0% in MCX-SX CCL.
- SME was incorporated as a subsidiary of MCX on September 14, 2010. SME intends to operate as a stock exchange to enable its members to transact, clear and settle trades in the small and medium enterprises equity and derivative segments. MCX has undertaken to subscribe to 51% of the shareholding in SME and received approval from FMC for an initial investment of Rs 510,000.

Investment Rationale

Leadership position in the commodity futures industry

MCX is the fifth largest commodity futures exchange globally, among all the commodity exchanges considered in the FIA survey, in terms of the number of contracts traded. Based on the comparison of the trading volumes of MCX with the leading global commodity futures exchanges in the world, for the calendar year 2010 and the six months ended June 30, 2011, MCX was the largest silver exchange, the second largest gold, copper and natural gas exchange and the third largest crude oil exchange for this period. We believe that the leadership position in these products gives MCX a competitive advantage.

Among the national commodities exchanges in India, the market share based on the total value of commodities traded in futures markets for 9MFY12 for gold, crude oil, silver, copper and natural gas futures contracts was approximately 97.1%, 94.8%, 98.5%, 94.9% and 99.9%, respectively. (Source: Information derived from FMC April – December 2011 data).

MULTI COMMODITY EXCHANGE

Product and Service Innovation

Since inception, MCX has introduced a variety of new commodity futures contracts on the exchange. The number of products offered has grown from 15 as of March 31, 2004 to 49 as of December 31, 2011. We believe that MCX will continue to focus on offering futures trading in commodities which are significant in the Indian and global contexts. Moreover, it plans to increase product portfolio through research and development efforts and through alliances with other exchanges. MCX claim to offer more customized products and services to attract a broader base of 54 participants.

Scalable technology platforms

The technology platform and business model of MCX is highly scalable and have the potential to generate better margins at greater volumes. It has made significant investments in developing fixed operating infrastructure, including technology systems, to support anticipated growth and increase in the demand for products. The current technology infrastructure is sufficient to handle daily trading volumes of up to 10,000,000 trades a day, and have handled a high of 1,867,612 trades in a day. We believe that the overall business model is highly scalable and that it offers potential for economic growth of MCX's business with limited incremental costs.

Technology infrastructure- Backbone of MCX

The technology infrastructure is the foundation of MCX and is a key factor in the development of MCX. The electronic platform is supported by strong infrastructure and advanced technology, allowing faster trade execution, anonymity, price transparency, prompt and reliable order routing, trade reporting, market data dissemination and market surveillance. The electronic trading platform is supplied by its promoter Financial Technology India Ltd (FTIL) — one of the leading technology companies in the development and deployment of exchange related software and technology in India. This technology for the exchange industry is difficult to replicate, thus providing it with a competitive advantage. MCX operates in an environment which requires constant technology upgrades or variations and support due to changes required by the regulatory regime and market forces. The technical expertise and experience of FTIL enables it to obtain speedy and efficient technology solutions, such as customization and development of new software for new products and services.

Expand Market Presence and Increase Participants

As of December 31, 2011, the company had 2,153 members nationwide with more than 296,000 terminals including CTCL spread over 1,572 cities and towns in India. Management intends to continue to increase the number of participants by introducing new products on the Exchange, by expanding to more geographical areas and by efforts to disseminate knowledge and information about the commodity futures industry. Going forward, Management plans to establish and grow presence in additional regions across India.

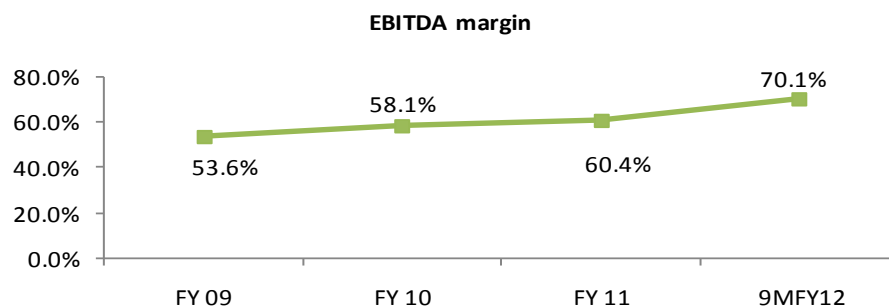
Unique business model

Global exchange models are high annuity, low capex and high dividend yielding companies. Global exchanges pay as high as 70-80% dividend. MCX on average has a dividend history of 25%. We believe that going forward the company will have a higher dividend payout ratio.

MULTI COMMODITY EXCHANGE

Strong earnings growth

MCX's sources of operating income are transaction fees, membership admission fees, annual subscription fees and terminal charges. MCX's operating revenue has grown at a CAGR of 32% over FY09-11, with major growth coming through transaction fees, which grew at a CAGR of 37% over the same period. EBITDA margin improved to 70.1% in 9MFY12 from 53.6% in FY09, on account of operating leverage – most of MCX's operating costs are fixed and semi-fixed in nature. Return on equity decreased marginally from 24.4% in FY09 to 22.8% in FY11. We expect MCX to be able to sustain its profitability going forward due to slower growth in operating costs vs revenue growth.



Source: Company data, Nirmal Bang Securities

Entry barrier

MCX is a leading commodity futures exchange in India in terms of value of commodity futures contracts traded in metals, energy and certain agricultural commodities. Over the years, MCX has established itself as a number one player in the India with a market share of more than 80%. Particularly in gold, crude oil, silver, copper and natural gas futures contracts MCX garners a market share of more than 95% over last 4-5 years. Thus, it has a strong competitive edge over its peers. This strong position of MCX also acts as an entry barrier for newer players. Further, the stringent regulatory rules and framework makes it very difficult for new players to enter this market.

Valuation and Peer Comparison

MCX faces competition in all aspects of its business and compete directly with four other national level commodity exchanges in India, namely NCDEX, NMCE, ICEX and ACE. It believes the principal factors affecting competition with its Exchange include product portfolio, quality of technology (which includes ease of use, connectivity, security, scalability and customer service), liquidity, transaction costs, speed of execution and transparency.

The Developed countries Exchanges like CME, CBOT enjoy an EBITDA margin of approximately 60% with a growth of around 9-10%. These exchanges enjoy a P/E of around 17-18x on CY12 earnings. The developing countries also enjoy an EBITDA margin of around 60% with a growth of 10-15% and enjoy a P/E of 24-25x on CY12E. Whereas, MCX being the first listed company is trading at a P/E of 18x on annualized FY12E earnings. We believe that MCX enjoys a lower multiple as compared to other exchanges even though the growth rate is higher. We believe that the valuations are attractive at current levels.

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	Mkt Cap (\$ bn)	P/E multiple
Singapore Exchange Ltd	6.11	24.83
Hong Kong Exchanges and Clearing	20.19	29.25
Intercontinental Exchange Inc	9.64	18.9
London Stock Exchange	4.01	12.37
MCX	1.063	18.11

MCX shares is offered at 4.9x P/BV and 18.11x P/E calculated at higher band of price for FY12E. We believe that the leadership position in the commodities industry with minimal competition, MCX will definitely command a premium multiple. Considering promoter’s position in the market, visible brand, better operational parameters & diversified portfolio, we expect MCX can command higher premium going ahead. Therefore, we recommend a **“SUBSCRIBE”**.

Key concerns

- MCX is subject to certain risks relating to the operations of electronic trading platform and it may be unable to keep up with rapid technological changes. Any failure to keep up with industry standards in technology and respond to participant preferences could cause its market share to decline, which could have an adverse effect on the company.
- The company has made investments in the form of equity share capital and warrants in MCX-SX. In the event of an adverse outcome in the outstanding litigation between MCX-SX and SEBI in relation to the application for diversification of trading operations, it may not be able to benefit from the investments as anticipated.
- The commodities trading industry has been and continues to be subject to strict regulatory requirements and scrutiny. MCX face the risk of changes in laws, regulations or governmental policies or taxation which may diminish the trading volumes or have an adverse effect on the way the commodity futures exchanges conduct their business. Further, new legislation, regulations or enforcement may require MCX to allocate more resources to regulatory compliance and oversight, impede its ability to operate and grow business, which would adversely affect the business, financial condition and results of operations.

MULTI COMMODITY EXCHANGE

Consolidated income statement	FY09	FY10	FY11	9MFY12
Income				
Transaction fees	186.1	264.1	349.5	386.8
Membership Admission fees	10.5	7.0	3.5	4.1
Annual subscription fees	13.6	13.6	13.5	9.88
Terminal charges	2.2	2.7	2.4	1.5
Income from operations	212.4	287.4	368.9	402.3
Other Income	153.4	206.3	78.7	72.2
Total Income	365.8	493.7	447.6	474.5
Expenditure				
Staff costs	25.4	21.8	26.4	20.14
Administration and other operating expenses	110.6	124.1	150.7	121.7
Depreciation/ Amortisation	20.0	24.7	24.7	20.44
Interest	0.2	0.0	0.0	0.00
Total Expenditure	156.2	170.6	201.8	162.3
Net profit before tax	209.7	323.1	245.8	312.2
Total Tax	52.2	102.4	72.5	91.7
Net profit after tax before share of profit of Associate	157.4	220.7	173.3	220.5
Share of profit of Associate	0.0	0.3	0.3	0.1
Net profit after tax	157.5	221.0	173.5	220.7

Source: Company data, Nirmal Bang Research

Consolidated Balance Sheet	FY09	FY10	FY11	9MFY12
Liabilities				
Share capital	40.8	40.8	51.0	51.0
Reserves and Surplus	453	656	798	1023
Deferred Tax Liability	9	11	12.7	15.7
Total Liabilities	502	708	862	1090
Fixed Assets				
Gross block	259	268	291.653	309.54
Less : Accumulated depreciation/ amortisation	51	75	96.36	116.539
Net block	209	193	195	193
Investments	470	617	823.74	1095.812
Current Assets, Loans and Advances				
Sundry debtors	27	30	48.868	49.403
Cash and bank balances	406	270	331.17	228.566
Other Current Assets	9	8	11.31	9.67
Loans and advances	45	111	89.66	96.088
Total	487	419	481	384
Current liabilities and provisions	663	521	638.55	582.977
Net CACL	-176	-102	-158	-199
Total Assets	502	708	862	1,090

Source: Company data, Nirmal Bang Research

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