

MULTI COMMODITY EXCHANGE

Structural levers in place

India Equity Research | Banking and Financial Services



Edelweiss
Ideas create, values protect

Multi Commodity Exchange's (MCX) Q2FY13 PAT of INR814mn, up 26% QoQ AND down 9% YoY, surpassed our INR654mn expectation. We were estimating earnings growth in line with average daily trading volume (ADTV) growth of 7% QoQ (down 19% YoY) in Q2FY13. While operating income grew in line with our estimate, beat was on other income of INR283mn (INR181mn in Q1FY13); this is primarily investment income on margin money. Operating margin (adjusting for deviation in other income) was sustained at ~68%. Earning/valuations will draw comfort from optional value attached to regulatory changes boosting trading volumes and better-than-expected scale up of MCX-SX. Maintain 'BUY'.

Robust volumes in September post lower volatility in Apr-Aug

Gold and silver, key volume movers last year, had set a high base for ADTV at INR650-700bn in August and September 2011. However, due to low volatility across these commodities in FY13 (as INR depreciation had nullified the impact of higher volatility in global prices), YTD volume in gold and silver (in value terms) dipped 12% and 27%, respectively (in volume terms it was down 22% and 26%, respectively), over FY12. Increased volatility in crude oil aided growth of 19% (both in value and volume terms) in this product segment. Base metals including copper, lead and nickel also posted volume uptick. Overall, ADTV in Q2FY13 was down 19% YoY to INR510bn. However, volumes gained some momentum towards the fag end of Q2FY13 (in September) led by gold, silver and copper. Assuming better volume momentum in H2FY13 over H1FY13, we maintain ADTV assumption of INR530bn for FY13.

Outlook and valuations: Structural levers in place; maintain 'BUY'

We believe MCX, with eight years of operating history, is still in the growth phase of its life cycle (not maturity or decline phase). Though we are building in moderate volume growth in the near term, there are structural levers in place for an upward trajectory over the long term—options, institutional participation etc., (not captured in our estimates, but can boost volumes/earnings 25-30%). Moreover, our earnings do not take into account scale up and valuation upside from MCX-SX, though concrete steps towards its faster roll out have been initiated (direct equity holding + warrants can fetch valuation, equivalent to INR120-140 per share in 2-3 years). The stock is trading at 21x (1-year forward earnings). We maintain 'BUY/Sector Outperformer' with TP of INR1,710 (upside of >20%).

Financials

Year to March	Q2FY13	Q2FY12	Growth %	Q1FY13	Growth %	FY12	FY13E	FY14E
Revenue (INR mn)	1,648	1,613	2.2	1,462	12.7	6,289	6,725	7,669
PAT (INR mn)	814	894	(9.0)	647	25.8	2,977	3,148	3,633
EPS (INR)	15.96	17.53	(9.0)	12.69	25.8	58.4	61.7	71.2
ADTV (INR bn)	510.5	629.1	(18.8)	478.9	6.6	503.1	532.8	615.4
P/E (x)						24.3	22.9	19.9
P/B (x)						7.2	5.9	4.9

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA (R: MCEI.BO, B: MCX IN)

CMP	: INR 1,416
Target Price	: INR 1,710
52-week range (INR)	: 1,447 / 838
Share in issue (mn)	: 51.0
M cap (INR bn/USD mn)	: 72/ 1,342
Avg. Daily Vol.BSE/NSE('000)	: 412.3

SHARE HOLDING PATTERN (%)

	Current	Q1FY13	Q4FY12
Promoters*	26.0	26.0	26.0
MF's, FI's & BK's	23.4	23.5	22.4
FII's	33.8	31.4	33.3
Others	16.8	19.0	18.3
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	10.2	(0.4)	10.6
3 months	33.9	9.0	4.7
12 months	NA	8.4	22.7

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MCX-SX set to make an impressive entry

MCX-SX, after bagging SEBI nod to deal in equity, equity F&O, interest rate futures and wholesale debt segments, has made a more than impressive start by signing up 700 plus members (higher than any other exchange before going live) ahead of launching trading (likely on Diwali) in multiple assets. The two other Indian exchanges viz., BSE/NSE had started operations with much lower number of 318/200 members. With MCX-SX already launching its flagship "SX-40" index and plans afoot to roll out several indices with sectoral flavour as well as international markets, performance is likely to get a further leg up.

Our earnings do not take into account scale up from MCX-SX, though credible steps towards its faster roll out have been initiated. MCX's direct equity holding of 5% and warrants equivalent to 33% in MCX-SX can fetch valuation equivalent to INR120-140 per share in two-three years (based on assumption of MCX's stock exchange being able to command 25% of valuation of leading exchange in India and ascribing 50% valuation discount to warrants).

Revision in technology sharing agreement with FTIL: Overhang settled

MCX's technology sharing agreement with FTIL has been revised w.e.f. October 2012:

- Fixed fee of INR10mn per month has been revised to INR20mn per month (revised up after five years to cover employee cost and general inflation).
- Variable fees have been kept unchanged at 12.5% of gross transaction fee. Terms of agreement, due for renewal every five years, have now been extended to 33 years.

Since the variable component was revised up in July 2010 from 10.0% to 12.5%, despite more than 40% CAGR in volumes during FY07-10, giving rise to scepticism that the variable fee can be revised up further as the technology cost sharing with FTIL was implied to be more back-ended to make the exchange venture viable in an initial phase. By revising only the fixed structure (not tweaking the variable portion), the impact will be relatively lower given structural scale up in trading volumes over years.

Revision in fixed fee structure will have an earnings impact of 1.4% in FY13 (only for six months starting Oct 2012) and 2.2% in FY14. Operating margins will come off by ~90bps in FY13E and ~150 bps in FY14E.

FCRA Bill cleared by Cabinet; awaiting Parliament nod

The Cabinet has cleared the FCRA Bill, which, amongst providing financial autonomy to sectoral regulatory FMC, will also facilitate entry of institutional investors and introduction of options on commodity exchanges.

- Currently, regulations do not permit MFs, FIIs and banks to trade on commodity exchanges. If allowed, this may drive overall participation in the segment.
- Commodity options were banned in 1952. Globally, options contribute ~50% of derivatives volume traded on exchanges. MCX has already developed the software technology infrastructure to launch trading in options, when such trading is permitted.

Our estimates/valuation do not factor in scale up in trading volumes of MCX resulting from opening of option trading or participation of banks/MFs/FIIs, which can boost volumes by atleast 25-30% seeing the trend of option volume/institutional participation in global exchanges and domestic stock exchanges.

Table 1: Volume led by crude oil and base metals (INR bn)

	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13
Average Daily Trading Volumes	629.1	505.5	469.7	478.9	510.5
-Gold	216.7	145.4	120.7	124.5	124.1
-Silver	230.5	156.8	151.2	142.9	135.5
-Crude Oil	87.4	94.6	73.3	86.8	118.8
-Agri	6.5	5.3	11.2	8.0	9.3
-Others	88.0	103.3	113.2	116.7	123.0

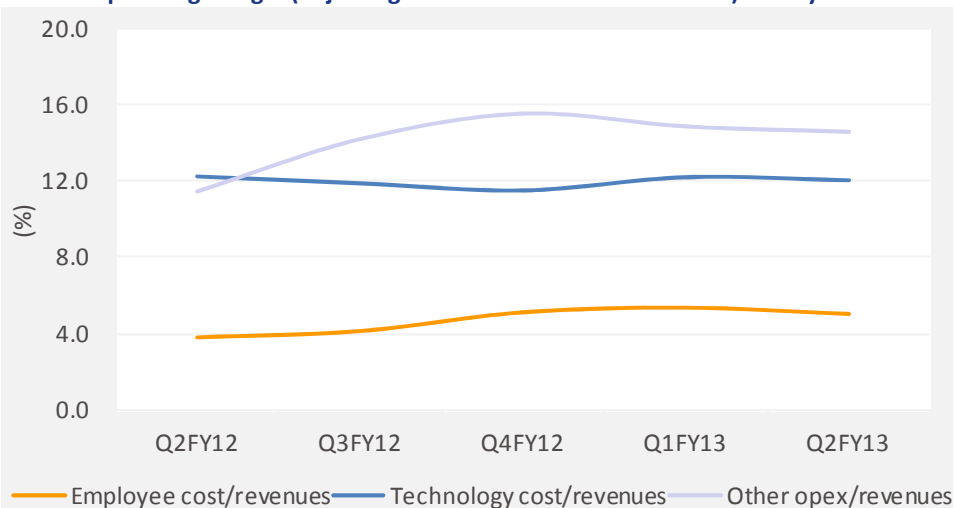
Source: Company, Edelweiss research

Table 2: Lower volatility in domestic prices led to decline in volumes for gold and silver

	Qty denomination	ADTV YTD FY13 (Apr-Oct)		ADTV FY12		Change in ADTV	
		Value (INR bn)	Volume	Value (INR bn)	Volume	Value	Volume
Gold	Gms	121.6	40,523	137.6	52,246	(11.6)	(22.4)
Silver	Kgs	136.2	2,395	186.9	3,241	(27.1)	(26.1)
Crude Oil	'000 BBLs	103.6	20,710	86.9	17,430	19.2	18.8
Copper	Kgs	53.5	125,240	48.5	119,683	10.3	4.6
Zinc	Kgs	11.6	111,251	11.5	114,394	0.7	(2.7)
Lead	Kgs	15.1	136,482	11.1	102,400	35.9	33.3
Nickel	Kgs	14.6	15,830	13.2	13,163	10.7	20.3

Source: Company

Chart 1: Operating margin (adjusting for deviation in other income) steady



Source: Company

Financial snapshot								
(INR mn)								
(INR mn)	Q2FY13	Q2FY12	Growth (%)	Q1FY13	Growth (%)	FY12	FY13E	FY14E
Revenues	1,648	1,613	2.2	1,462	12.7	6,289	6,725	7,669
Expenses	493	491	0.5	474	4.0	1,915	2,056	2,307
- employee cost	78	67	15.2	78	0.1	280	287	328
- software support charges	188	219	(14.1)	179	5.1	789	883	1,047
- other expenses	227	204	11.2	217	4.5	847	886	932
EBIDTA	1,155	1,292	(10.6)	988	16.8	4,374	4,669	5,362
- Interest	0	0	(55.0)	0	(30.8)	0	0	0
- Depreciation	71	71	(0.1)	67	5.6	272	297	316
PBT before exceptional items	1,084	1,221	(11.2)	921	17.7	4,102	4,372	5,046
Exceptional items						142		
PBT	1,084	1,221	(11.2)	921	17.7	3,960	4,372	5,046
Tax	270	327	(17.4)	274	(1.5)	1,125	1,224	1,413
PAT	814	894	(9.0)	647	25.8	2,977	3,148	3,633
Ratios (%)								
EBITDA margin	70.1	72.5		67.6		69.5	69.4	69.9
PBT margins	65.8	68.5		63.0		65.2	65.0	65.8
PAT margin	49.4	50.2		44.3		47.3	46.8	47.4
Employee cost/revenues	4.7	3.8		5.3		4.4	4.3	4.3
Software charges/revenues	11.4	12.3		12.2		12.5	13.1	13.7
Tax rate	24.9	26.8		29.7		28.4	28.0	28.0

Company Description

MCX is a demutualised nationwide electronic commodity futures exchange promoted by FTIL and has received permanent recognition from Government of India for facilitating online trading, clearing & settlement operations for futures market across the country. The exchange started operations in November 2003 and within eight years it has emerged the market leader in commodities future industry with 85% plus market share, leveraging on product and service innovations and effective use of technology.

It offers trading in 49 commodity futures and have 2,170 members on its platform, with over 346,000 terminals including CTCL spread over 1,572 cities and towns across India. The exchange has also emerged as the third largest and amongst the fastest growing commodity futures exchanges in the world in terms of number of contracts traded in CY11 (*Source FIA*). MCX has registered largest volumes (in terms of the number of contracts traded) in CY11 in silver and gold, second largest in natural gas and third largest in crude oil and copper.

MCX has been certified to three ISO standards, including ISO 9001:2008 Quality Management System standard, ISO 14001:2004 Environmental Management System standard, and ISO 27001:2005 Information Security Management System standard.

Investment rationale

We like MCX for its market leadership, early mover advantage, edge in innovation, technology support from FTIL and sticky liquidity. The exchange, with eight years of operating history, is in a growth phase with structural levers in place for an upward trajectory in volume over the long term. Until a new player poses a stiff competition or institutions are permitted to participate on CommEx, we expect MCX's commission yields to stabilise. Compared with global peers, MCX valuations are at par with matured exchanges in developed nations and at 15%-20% discount to valuations of listed CommExes in developing markets. Our estimates/valuation do not take into consideration the following possibilities: (1) opening of option trading or participation by FIIs, MFs, banks etc; (2) revision in variable fee structure for technology cost sharing with FTIL and (3) scale up and valuation upside from MCX-SX.

Key Risks

- Higher regulatory risks due to speculative nature of trades
- Growing competition
- Significant dependence on a few commodities
- Long-term pricing pressure likely in commodities futures
- Revenues tied to transaction fee and market volatility
- Credit risk of members

Financial Statements

Key assumptions

	MCX	FY10	FY11	FY12	FY13E	FY14E
Macro						
	GDP(Y-o-Y %)	8.4	8.4	6.5	5.8	6.5
	Inflation (Avg)	3.6	9.9	8.8	7.8	6.0
	Repo rate (exit rate)	5.0	6.8	8.5	7.5	6.8
	USD/INR (Avg)	47.4	45.6	47.9	53.5	52.0
Company						
	Avg daily trading volumes	208.3	320.6	503.1	532.8	615.4
	Commission yields	2.0	1.8	1.6	1.6	1.6
	# of terminals	117,124	194,400	346,000	397,900	437,690
	Employee cost/revenues	6.1	5.9	4.4	4.3	4.3
	Tech cost/revenues	11.7	12.8	12.5	13.1	13.7

Income statement

(INR mn)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Revenues	3,566	4,473	6,289	6,725	7,669
- Transaction Fee	2,641	3,495	5,065	5,335	6,143
- Membership Fee/Terminal charges	233	194	197	211	221
- VSAT Connectivity Inc	63	41	43	44	45
- Interest & Dividend & Investment Income	467	550	830	967	1,081
- Other Income	163	193	154	168	179
Operating expenses	1,458	1,771	1,915	2,056	2,307
- Employee Cost	218	264	280	287	328
- Technology Costs	417	573	789	883	1,047
- Advt. & Business Development	190	240	156	165	174
- Admin & Other Expenses	634	695	691	722	758
Operating margin	2,109	2,702	4,374	4,669	5,362
Depreciation & Amortization	247	247	272	297	316
EBIT	1,861	2,455	4,102	4,372	5,046
PBT	1,861	2,455	4,102	4,372	5,046
Investment Income (Sale of Strategic Investments)	1,369	0	0	0	0
PBT including extraordinary income	3,230	2,455	4,102	4,372	5,046
Tax	1,024	727	1,125	1,224	1,413
PAT	2,206	1,728	2,977	3,148	3,633
Impact of prior period	(2)	29	(115)	-	-
Net profit (reported)	2,204	1,757	2,862	3,148	3,633
Diluted EPS (INR)	27.0	33.9	58.4	61.7	71.2
DPS (INR)	3	5	24	15	18
Dividend payout	9	15	41	25	25

Growth ratios (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Revenue growth	21.7	25.4	40.6	6.9	14.0
- Transaction fee growth	41.9	32.4	44.9	5.3	15.1
Opex growth	7.6	21.5	8.1	7.4	12.2
Operating margin growth	33.8	28.1	61.9	6.7	14.9
PBT growth	35.3	31.9	67.1	6.6	15.4
PAT growth	38.3	(20.3)	62.8	10.0	15.4

Operating ratios (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating margin	59.1	60.4	69.5	69.4	69.9
PAT margin	61.9	38.6	47.3	46.8	47.4
Employee cost/revenues	6.1	5.9	4.4	4.3	4.3
Technology cost/revenues	11.7	12.8	12.5	13.1	13.7
Opex/revenues	40.9	39.6	30.5	30.6	30.1
Tax rate	31.7	29.6	27.4	28.0	28.0

Balance sheet

(INR mn)

As on 31st March	FY10	FY11	FY12	FY13E	FY14E
Liabilities					
Equity Capital	408	510	510	510	510
Reserves (excluding revaluation reserves)	6,562	7,975	9,460	11,687	14,258
Net Worth	6,970	8,485	9,970	12,197	14,768
Deferred Tax Liability (Asset)	106	127	151	175	203
Total	7,076	8,612	10,121	12,372	14,971
- Gross Block	2,681	2,917	3,112	3,262	3,407
- Depreciation	754	964	1,235	1,532	1,848
- Net Block	1,928	1,953	1,877	1,730	1,559
Investment	6,172	8,236	11,502	13,002	15,302
Current Assets	4,190	4,808	4,743	5,763	6,719
- Cash and Bank Balance	479	612	588	892	1,258
- Fixed Deposits	2,221	2,698	2,598	3,048	3,498
- Sundry debtors	304	489	514	704	811
- Loan & advances	1,108	897	906	955	955
- other current assets	78	113	137	164	197
Current Liabilities	4,914	6,045	6,431	7,002	7,346
- Security Deposits	113	105	110	110	110
- Networking Equipment Deposits	26	15	15	15	15
- Trading Margin from Members	4,082	5,283	5,568	6,102	6,407
- Other Current liabilities	693	642	739	775	814
Net Current Assets	(724)	(1,236)	(1,688)	(1,239)	(627)
Provisions	300	341	1,570	1,121	1,263
Total	7,076	8,612	10,121	12,372	14,971

Key operating metrics

Year to March	FY10	FY11	FY12	FY13E	FY14E
Average Daily Trading Volumes	208.3	320.6	503.1	532.8	615.4
- Gold	62.6	80.4	137.6	142.5	167.7
- Silver	37.2	87.9	186.9	168.9	198.8
- Crude Oil	50.3	66.7	86.9	104.3	117.0
- Agri	2.3	3.7	6.4	9.0	11.7
- Others	55.8	81.7	85.3	108.2	120.2
Commission yields	2.0	1.8	1.6	1.6	1.6
# of members	2,070	2,119	2,170	2,222	2,286
# of employees	341	333	240	250	250
# of terminals	117,124	194,400	346,000	397,900	437,690

Valuation metrics

Year to March	FY10	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	27.0	33.9	58.4	61.7	71.2
EPS growth (%)	39.6	25.3	72.3	5.7	15.4
Book value per share (INR)	85.4	166.4	195.5	239.2	289.6
RoE (%)	37.0	22.7	31.0	28.4	26.9
Diluted P/E (x)	52.4	41.8	24.3	22.9	19.9
Price/ BV (x)	16.6	8.5	7.2	5.9	4.9
Dividend yield (%)	0.2	0.4	1.7	1.1	1.3

Peer comparison valuation

	Price (INR)	Mcap (INR bn)	P/ABV		ROE (%)		P/E (x)	
			FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
HDFC Ltd	766	1,181	4.8	3.9	22.4	22.5	23.9	20.0
IDFC	168	255	1.9	1.6	14.0	15.3	13.9	11.3
LIC Housing Finance	250	126	1.8	1.6	16.3	18.2	12.6	9.1
Mahindra Finance	890	93	2.7	2.3	25.3	24.3	11.2	9.7
Manappuram Finance	37	31	1.1	0.9	21.6	20.7	5.3	4.7
MCX	1,416	72	5.9	4.9	28.4	26.9	22.9	19.9
Muthoot Finance	185	69	1.8	1.4	30.6	29.2	6.7	5.5
PFC	189	249	1.2	1.0	18.5	18.9	6.3	5.3
Reliance Capital	392	96	0.8	0.7	6.4	6.9	12.5	11.0
Rural Electrification Corp	220	218	1.3	1.1	23.4	22.5	6.0	5.3
Shriram City Union Finance	821	43	2.1	1.7	23.6	23.9	9.7	7.9

Source: Bloomberg, Edelweiss research



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	HOLD	SP	M	Axis Bank	BUY	SO	M
Bank of Baroda	BUY	SP	M	Federal Bank	BUY	SO	L
HDFC	HOLD	SU	L	HDFC Bank	HOLD	SP	L
ICICI Bank	BUY	SO	L	Indian Overseas Bank	HOLD	SU	M
IndusInd Bank	BUY	SP	L	Infrastructure Development Finance Co Ltd	BUY	SO	L
ING Vysya	BUY	SO	L	Karnataka Bank	BUY	SO	M
Kotak Mahindra Bank	REDUCE	SU	M	LIC Housing Finance	BUY	SO	M
Mahindra & Mahindra Financial Services	BUY	SO	M	Manappuram General Finance	BUY	SO	M
Multi Commodity Exchange of India	BUY	SO	M	Muthoot Finance	BUY	SO	M
Oriental Bank Of Commerce	BUY	SO	L	Power Finance Corp	BUY	SO	M
Punjab National Bank	HOLD	SU	M	Reliance Capital	BUY	SO	M
Rural Electrification Corporation	BUY	SO	M	Shriram City Union Finance	BUY	SO	M
South Indian Bank	HOLD	SP	M	State Bank of India	BUY	SO	L
Union Bank Of India	BUY	SO	M	Yes Bank	BUY	SO	M

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Allahabad Bank, Axis Bank, Bank of Baroda, Federal Bank, HDFC, HDFC Bank, ICICI Bank, Infrastructure Development Finance Co Ltd, IndusInd Bank, Indian Overseas Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, Multi Commodity Exchange of India, Manappuram General Finance, Mahindra & Mahindra Financial Services, Muthoot Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, State Bank of India, Shriram City Union Finance, South Indian Bank, Union Bank Of India, ING Vysya, Yes Bank

Recent Research

Date	Company	Title	Price (INR)	Recos
02-Nov-12	Rural Electrification Corporation	NIMs rise further; no incremental slippages; <i>Result Update</i>	220	Buy
02-Nov-12	Union Bank	Performs on asset quality with controlled slippages; <i>Result Update</i>	223	Buy
01-Nov-12	Shriram City Union Finance	Growth buoyant; NIMs stable; <i>Result Update</i>	789	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	113	53	19	186
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	14	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

DISCLAIMER

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