Initiating Coverage | 12 September 2012

Multi Commodity Exchange

Monopolistic. Cutting-edge. Xciting!

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MCX: Monopolistic. Cutting-edge. Xciting!

Multi Commodity Exchange of India

BSE SENSEX	S&P CNX
17,853	5,390

Bloomberg	MCX IN
Equity Shares (m)	51.0
52-Week Range (INR)	1,429/838
1,6,12 Rel. Perf. (%)	2/-9/-
M.Cap. (INR b)	59.9
M.Cap. (USD b)	1.1

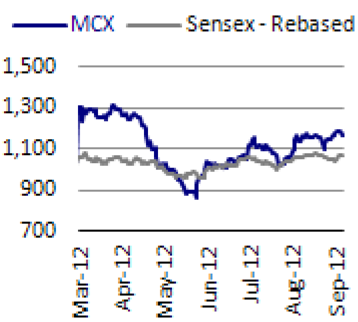
Financial summary (INR m)

Y/E March	2012	2013E	2014E
Sales	5,262	5,172	6,152
PAT	2,862	2,824	3,394
EPS (INR)	56.1	55.4	66.5
EPS Gr. (%)	65.6	(1.3)	20.2
P/E (x)	**20.9**	**21.2**	**17.6**
P/BV (x)	6.0	5.3	4.6
RoE (%	31.0	26.5	27.8
RoCE (%)	24.8	25.5	26.9
EV/Sales (x)	9.1	9.0	7.4
EV/ EBITDA (x)	14.3	14.7	11.5
Payout (%)	50.0	52.8	49.2

Shareholding pattern %

As on	Jun-12	Mar-12
Promoter	26.0	26.0
Domestic Inst	23.5	22.4
Foreign	31.6	33.3
Others	18.9	18.3

Stock performance (1 year)



Investors are advised to refer through disclosures made at the end of the Research Report.

CMP: INR1,174 | **TP: INR1,440** | **Buy**

Monopolistic. Cutting-edge. Xciting!

Dominant share; future ready; high growth potential

- **Multi Commodity Exchange of India (MCX) is a state-of-the-art electronic commodities futures exchange, with near monopolistic market share (86% in FY12).**
- **Our expectation of sustained market leadership stems from its technological edge and future readiness.**
- **MCX's volumes have grown at a CAGR of 47% over FY07-12. Future potential remains exciting given: [1] likelihood of new products and participants with the FCRA Bill, [2] with 2m client accounts as compared with 19-20m demat accounts, the industry has only scratched the surface with respect to potential volumes.**
- **We believe value from MCX-SX (Stock exchange promoted by MCX and FTECH in 2008) is more definite than merely option value. Policy to maintain ~50% payout ratio is a key valuation positive. Our target price of INR1,440 implies 23% upside. We initiate coverage with a Buy rating.**

Leading exchange, with contract volumes matching global leaders

Multi Commodity Exchange of India Limited (MCX) is a state-of-the-art electronic commodity futures exchange, offering futures trading in over 47 commodities, mainly including Gold, Silver, Copper and Crude Oil. It began operations in November 2003, and has over 86% share (as at 31 March 2012) of the Indian commodity futures market. In terms of contracts traded in CY11, it is the third-largest globally, second-largest in Gold, largest in Silver, second-largest in Natural Gas, and third-largest in crude oil.

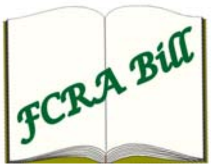
5-year volume CAGR of 47%; huge growth potential

Volumes continue to grow at a healthy rate in a less-than-a-decade old and highly regulated industry (CAGR of 51% over FY09-12). At MCX, volumes have grown at a CAGR of 47% over FY07-12. Growth potential remains huge:

1) Number of clients trading on the commodities platform are less than 2m, as compared to an estimated 18-20m in equities. Globally, the number of clients trading in commodities is higher than those trading in equities.
2) Globally, futures Gold volumes are 70-80x that of physical trade, v/s 17-18x in India, 20x in Crude v/s ~7x in India, 100x in Aluminum v/s 8-9x in India.

Technological edge, future readiness to help sustain market leadership

MCX has held on to its market leadership position, with a share of 82-87% over FY09-12. Supply of technology platform by its parent, Financial Technologies India (FTECH), one of the leading developers of exchange related software and technology, gives MCX a competitive edge that is difficult to replicate. If and when commodity exchanges in India receive regulatory approval to trade in new products like options, MCX will be able to quickly latch on to the opportunity, having invested significant resources to ensure readiness for the same. Additionally, new revenue sources like market data products and information offerings will lend scalability.



Two potential value drivers

#1: Regulatory changes post the passage of the FCRA Bill: We understand from the management that the Bill to amend the outdated Forward Contracts (Regulation) Act (FCRA) could be passed by the Parliament in the forthcoming session. This will give a fillip to MCX's volumes on the following counts:

1) introduction of options trading,
2) introduction of new commodity classes such as freight, rainfall and commodity indices
3) increased investor participation, as banks, mutual funds and foreign institutional investors could be allowed to transact on India's commodity futures markets.

#2: Value unlocking from MCX-SX: MCX-SX is a stock exchange recognized by SEBI, that was promoted by MCX and FTECH in 2008, with currency futures and options currently trading on the exchange. MCX-SX was recently cleared to become a full-fledged stock exchange. Despite intense competition, we do not rule out the possibility of the exchange garnering significant share, even if not match NSE's coup over what was largely a BSE dominated space till 1992. The last transaction in NSE happened at 11x revenues, which is also the multiple at which emerging market exchanges like the Singapore Exchange trade. We expect MCX's revenues to surge from INR391m in FY11 to at least ~INR1b by FY13, on:

1) 7 months of transaction charges in currency futures segment in FY12
2) additional 4 months of transaction charges in currency futures in FY13 and ~8 months of revenues from currency options
3) potential revenues from launch of equity operations.

Sustainable growth; value unlocking; healthy payout - Buy

MCX's volumes have grown at a CAGR of 47% over FY07-12. With the industry nascent, and growth potential significant from multiple triggers, we expect sustained double digit volume growth over the medium-to-long term, notwithstanding impact from phases of low volatility.

We expect volume CAGR of 15% and PAT CAGR of 13% over FY12-15. Also, the RoE should sustain at the high 20's. The company's decision to maintain its payout ratio at ~50% too is a key valuation positive, and will support high multiples.

We value the standalone commodity exchange business at 20x FY14E earnings, in line with the average multiple for global peers in emerging markets, despite MCX's better competitive positioning and higher growth potential. This translates into a value of INR1,330/share for the standalone commodity exchange business. We value MCX-SX at INR14b, 11x the potential revenues of INR1.3b in FY14 (transactions in FY10 had valued MCX-SX at INR45b). MCX's share in MCX-SX (including warrants) contributes additional INR110/share to its valuation. Our target price is INR1,440. **Buy** for 23% upside.

Key positives

- ✓ Near-monopoly market share
- ✓ Huge potential to grow volumes
- ✓ Future-readiness
- ✓ Likely FCRA boost
- ✓ Potential value unlocking from MCX-SX
- ✓ Payout ratio

Key risks

- ? Commodity prices
- ? Increase in transaction fee by FTECH
- ? Regulatory environment
- ? Concentration risk

Nascent industry; significant growth potential...

... from increasing penetration, new products, new participants

- **The government of India (GoI) authorized the establishment of commodity exchanges in India only in April 2003, and the industry is far from mature.**
- **Volume growth remains healthy in less-than-a-decade old and highly regulated industry. The total value of commodity futures traded in India has grown at a CAGR of 51% over FY09-12.**
- **Growth potential remains significant given [1] 2m client accounts as compared with 19-20m demat accounts, while globally the number exceeds equity members, [2] Derivatives volumes as a multiple of physical trades is far lower than that seen across the globe.**
- **Continued demand for underlying commodities in a growing economy and expansion in the mix of hedgers and speculators will facilitate continued growth in traded volumes.**

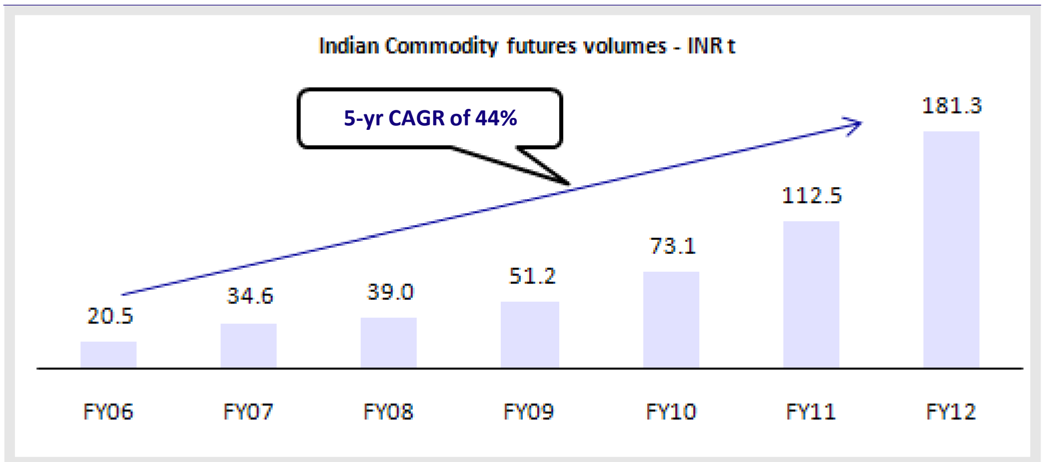
Nascent industry has registered high growth on a low base

Nascent industry, volumes CAGR of 44% over past 6 years

There are over 30 commodity futures and options exchanges worldwide, where commodities like energy, metals, agricultural products and livestock are traded. The total contracted commodity trading volume on these exchanges increased from 188m contracts in FY84 to 22,295m contracts in FY10, implying a CAGR of 20.2% over the 26-year period. In terms of traded value, Indian commodities futures volumes have gone up from INR20.5t in FY06 to INR181.3t in FY12, a CAGR of 44% during this period.

Spurt in volumes of Gold (FY11 and FY12) and Silver (FY12) drove increase in overall volumes

Trading volumes increased at a CAGR of 44% over FY06-12



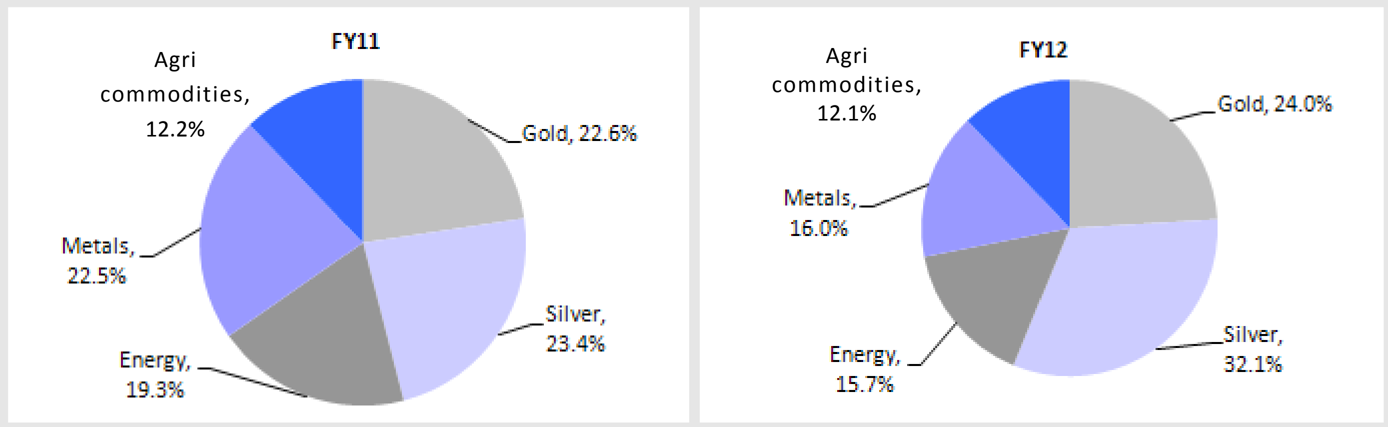
Source: Company, MOSL

5 Commodity exchanges, including NCDEX, NMCE, ICEX and ACE have a combined market share of ~99.5%+

In India, there are currently 21 commodity exchanges and associations, which are recognized by the GoI and authorized to organize and regulate futures trading. Of these, 16 are regional or localized exchanges, and five electronic exchanges have come up after the GoI authorized the establishment of national multi-commodity exchanges in April 2003. These are: Multi Commodity Exchange of India (MCX), National Commodity & Derivatives Exchange (NCDEX), National Multi-Commodity Exchange of India (NMCE), Indian Commodity Exchange (ICEX), and Ace Derivatives and Commodity Exchange (ACE). Four of these – MCX, NCDEX, NMCE and ICEX – account for over 98% of the turnover.

The market is at a relatively nascent stage with Gold, silver, crude oil and copper being the four largest commodities traded on the Indian exchanges, constituting 70%+ of the total traded value in FY11 and 80%+ of the total traded value in FY12.

Indian commodity exchange volumes concentrated towards gold, silver, copper and crude oil



Source: Company, MOSL

Operating in a highly regulated environment

Current regulations do not allow trading in options, do not allow participation from MFs, FIIs and banks

The industry is highly regulated. The Forward Contracts (Regulation) Act, 1952 (FCRA) is the principal legislation for the commodity futures market in India. The FCRA and the Forward Contracts (Regulation) Rules, 1954 (FCRR) provide for the regulation of commodity futures trading under a three-tier system, which consists of the following governing bodies:

- the Department of Consumer Affairs, Ministry of Consumer Affairs Food and Public Distribution,
- the Forward Markets Commission (FMC), and
- an Exchange or Association recognized by the GoI on the recommendation of the FMC.

In the current regulatory environment, foreign institutional investors (FIIs), banks and mutual funds cannot trade on commodity exchanges. Further, trading in options on commodity futures is prohibited in India. The two constraints have been thus far have been limiting the volumes potential on the exchanges.

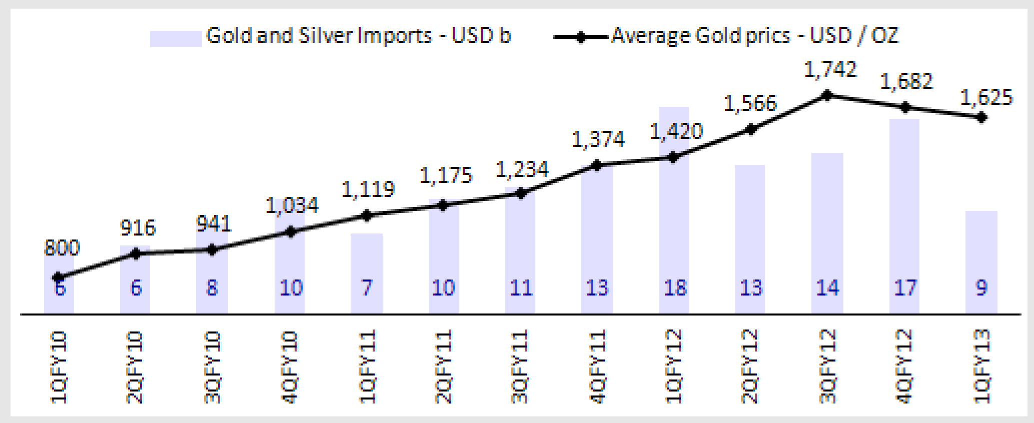
Growing demand for commodities and need to hedge will drive volumes

Growth potential in the economy like India's remains huge over the next decade, which is expected to drive the demand for commodities. The increase in physical market volumes consequently increases the hedging requirements for industry players, influencing derivative trading volumes. We expect the industry continue to register high growth rates given that:

1) In developed markets, commodity derivatives volumes are at a much higher multiple of the underlying physical commodity volumes. Indian commodities market is ~4x the physical market, compared to 35-40x being the average range globally. Futures volumes are 70-80x that of that of physical trade in Gold, v/s 17-18x in India, 20x in crude v/s ~7x in India, 100x in Aluminium v/s 8-9x in India.

2) The total number of clients trading on commodities platform are less than 2m, as compared to that in equities is estimated at ~18-20m. Globally, number of clients trading in commodities is higher than those on equities.

Increasing prices had not deterred the surge in imports before 1QFY13



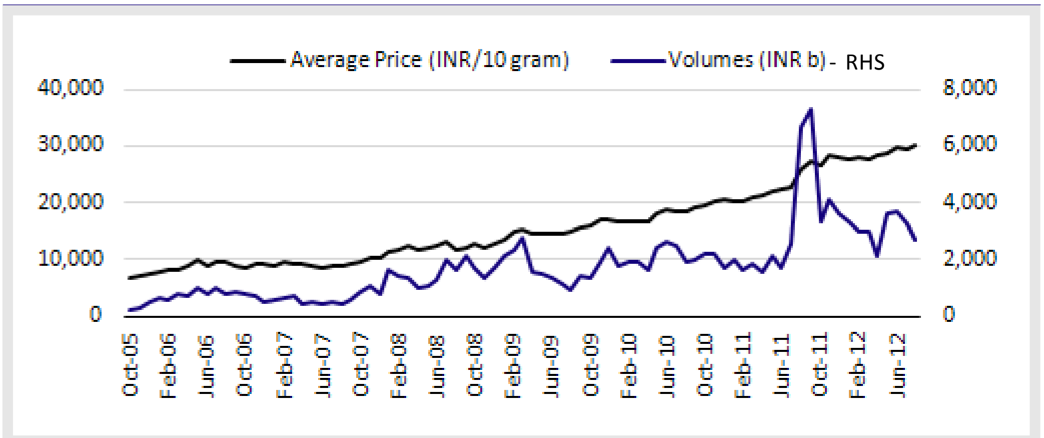
Source: Company, MOSL

Higher price volatility should increase speculator participation

Growth in trading volumes of any commodity on the exchanges has been a function of price volatility. In this perspective, MCX enjoys an advantage, given the variety of commodities that are traded on the exchange (although only four commodities drive majority of the volumes today). Thus, the company benefits from volatility in gold prices at one point, and silver, copper or crude prices at other points. As long as there is volatility in the prices of a particular commodity, it will act as a volume growth driver for the exchange.

Barring the recent volatility spurt, volumes have had a strong correlation with commodity's price

Volumes traded and commodity prices have had high correlation, except in recent months (Gold)



Source: Company, MOSL

Takeaways from interaction with NCDEX and FMC

FMC: Role limited in current environment; industry far from mature

"There seems to be lack of unanimous agreement within the Government on the need for a futures market in commodities"

- Indian commodities exchange market is far from mature, and is still in a learning process. There is a lack of unanimous agreement within the government on the need for futures market in commodities, which has been the key hindrance in the passage of amendments to the FCRA bill.
- FMC's role is highly limited in its current form of existence. This is because unlike SEBI, FMC is not an autonomous body, as a result of which, it is unable to take decisions on its own accord. It does not even enjoy financial independence. However, despite a moderate control environment, FMC is not witnessing rampant unfair practices on the exchange.
- Due to limited powers, it is currently unable to levy penalties on members who breach the trading guidelines on the exchange. Currently, it is up to the exchanges to levy these penalties.
- Globally, there are separate regulators for commodities exchanges and equity exchanges, and it makes a strong case for a similar structure in India too.
- There is some interest on margin money, which is now being collected towards Investor Protection Fund. The FMC has collected ~INR650m and it should continue to grow.

NCDEX: Slow and gradual progress in Indian market evident, suitable

NCDEX's focus on commodities relevant to India may have cost it market share in popular global commodities

- The progress in the regulatory changes albeit slow, has been gradual in the evolving Indian Commodity Exchanges space, which still remains a very nascent industry. The pace of progress is not entirely unacceptable given the maturity of the industry today.
- It is still very early days for the Indian commodities industry, and the scope for growth remains huge. Type of participants will be allowed to increase eventually, given that the regulators would want to ensure there is market making for increasing number of hedgers.
- NCDEX tends to focus on commodities which are relevant to the domestic interests. In commodities (especially agricultural) where India has a significant contribution in the global scheme of things, the exchanges here should be price setters than price followers.
- Gold is one commodity, where India should not be a price follower, but that has not been the case so far. Endeavor at NCDEX is to facilitate an environment where this can be achieved.
- NCDEX's choice of role it envisaged to play in the commodities exchange also has a part to play in its lower market share v/s the leader.

Near monopolistic market share

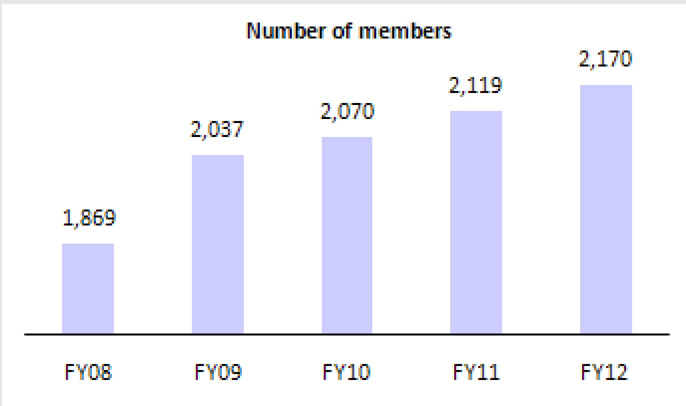
Technological edge, future readiness to help sustain leadership

- **Multi Commodity Exchange of India (MCX) has held on to its market leadership position, with a share of 82-87% over FY09-12.**
- **Supply of technology platform by Financial Technologies India (FTECH), one of the leading developers of exchange-related software and technology, gives MCX a competitive edge that is difficult to replicate.**
- **When commodity exchanges in India receive regulatory approval to trade in new products like options, MCX will be able to quickly latch on to the opportunity, having invested significant resources to ensure readiness for the same.**
- **Also, new revenue sources like market data products and information offerings will lend scalability.**

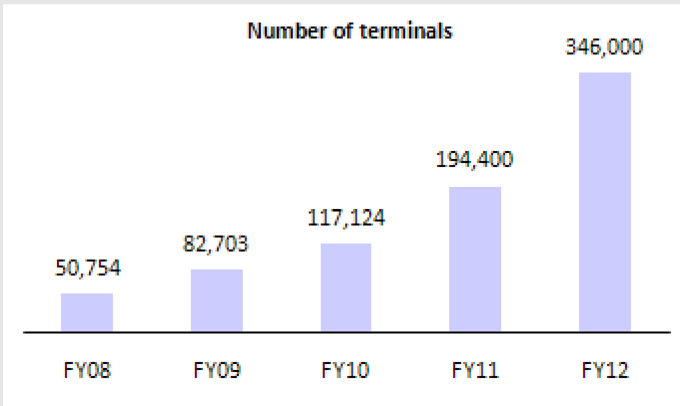
Wide reach, dominant market share

MCX has 2,170 members and 346,000+ terminals including computer-to-computer links (CTCLs) spread over 1,577 cities and towns across India as at the end of FY12. The number of terminals has increased from 117,000 in FY10. Healthy terminal additions partially offset the risk of lower volumes traded per member, with gradual ramp-up in volumes expected from new additions.

Member additions continue, though at a slower rate



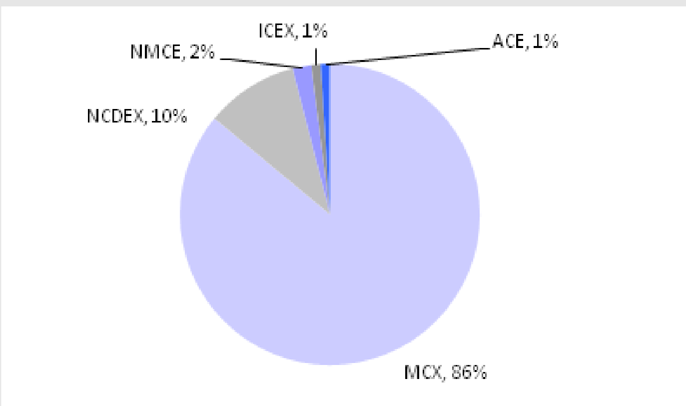
Growth in number of terminals remains strong

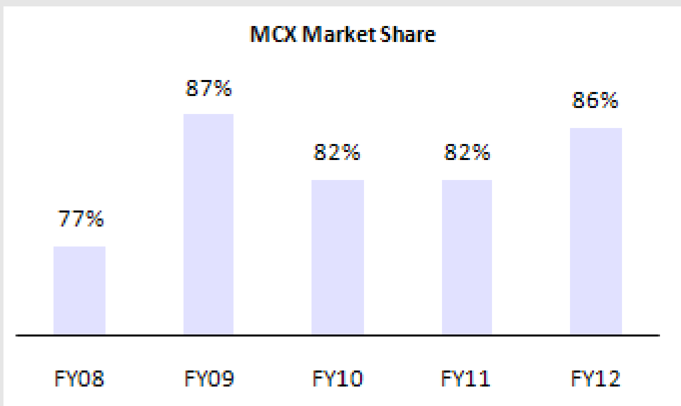


Source: Company, MOSL

MCX has maintained its leadership in the Indian commodity futures market, with 82% share in FY11 and 86% share in FY12, in terms of value of commodities traded in the futures market.

MCX enjoys a dominant market share, has maintained its leadership over the years





Source: Company, MOSL

Technological edge – parent's expertise a significant advantage

Infrastructure in place to support multifold growth in volumes without any incremental costs

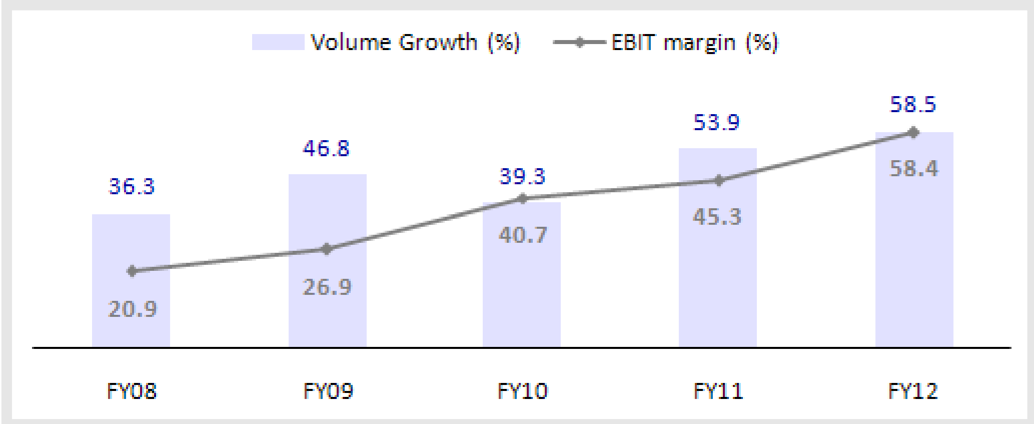
Exchange markets are characterized by rapid changes in technology, usage patterns and client preferences, frequent product/service introductions, and emergence of new industry standards/practices. MCX enjoys a competitive edge, given that its trading platform is supplied by its promoter, Financial Technologies India (FTECH), which is a leading developer of exchange related software and technology. Technology for the exchange industry is difficult to replicate, thus providing the company with a competitive advantage. Exchanges require constant technology upgrades and support, necessitated by regulatory regime and market forces. MCX is able to obtain speedy and efficient technology solutions from FTECH. MCX's current technology infrastructure is sufficient to handle daily trading volumes of up to 10,000,000. So far, it has handled a high of 1,867,612 trades in a day.

High operating leverage compounds benefits to bottom line

60-70% of expenses fixed; growth in volumes to boost margin

A large proportion of the costs at MCX are fixed. The only significant variable cost in its expenses is the fees paid as a percentage of transaction revenues towards technical services agreement to its parent FTECH. Fixed price have ranged between 60-70% of the overall expenditure at MCX for the past 6 years. Therefore, potential growth in volumes at MCX implies even better profitability going forward.

High operating leverage facilitated margin expansion as volumes grew



Source: Company, MOSL

Future ready – proactively investing to take advantage of anticipated changes

Will be able to quickly bring out the new products as and when regulatory approvals fall in place

MCX has invested significant resources to develop strategies and ideas for new products in anticipation of proposed policy initiatives or regulatory measures, particularly the proposal to amend the Forward Contract Regulation Act (FCRA). The proposed amendments relate to allowing trading in options and derivatives, demutualization of existing bourses and setting up of a separate clearing corporation. Such measures, if brought into force, can potentially drive a spurt in volumes, given the company's readiness for the same from a technology standpoint.

Scalable business model, with potential to generate revenue from new streams

Being the largest commodity exchange in India, with near-monopolistic market share, MCX is the key source of data on commodity trends. This gives MCX the opportunity to benefit from new non-transaction revenue sources like market data product and information offerings, as is the case for various leading exchanges in India and the rest of the world. This not only provides scalability to the business model, but also offers potential for growth with limited incremental costs. Growth in commodity markets facilitate demand for better trading and analytical tools, risk management tool, market data products and price information offerings which could be new revenue streams.

Algorithmic trades led data will drive additional revenue from information dissemination

Globally, exchanges derive 10-15% of their revenues from such services. Indian exchanges do not match that number, especially in equities, given weak acceptance of algorithmic trades. MCX is better placed to garner revenues from such sources, given its speedier execution in such trades, which already constitute significant proportion of the company's volumes.

To facilitate the same, MCX has entered into agreements with financial information service agencies to provide real time data-feed on trading prices, trading volume and other information on the commodity futures contracts which are traded on the Exchange and on the spot market. The company currently has such arrangements with the following entities:

1. Bloomberg Finance L.P.,
2. NewsWire 18 Private Limited,
3. IQN Data Solutions Private Limited,
4. Reuters India Private Limited,
5. Interactive Data (Europe) Limited and
6. TickerPlant Limited.

Two potential value drivers

Regulatory changes, value unlocking from MCX-SX

- **The Forward Contract Regulation Act (Amendment) Bill 2010 (FCRA Bill) has been on the agenda for cabinet discussion. If passed, it will give a fillip to MCX's volumes.**
- **MCX Stock Exchange (MCX-SX) was recently cleared to become a full-fledged stock exchange. We believe the value from MCX-SX is more definite than merely option value; FY14 is expected to be first full year with operations in currency and equities.**

Likely stimulus to volumes from FCRA Bill

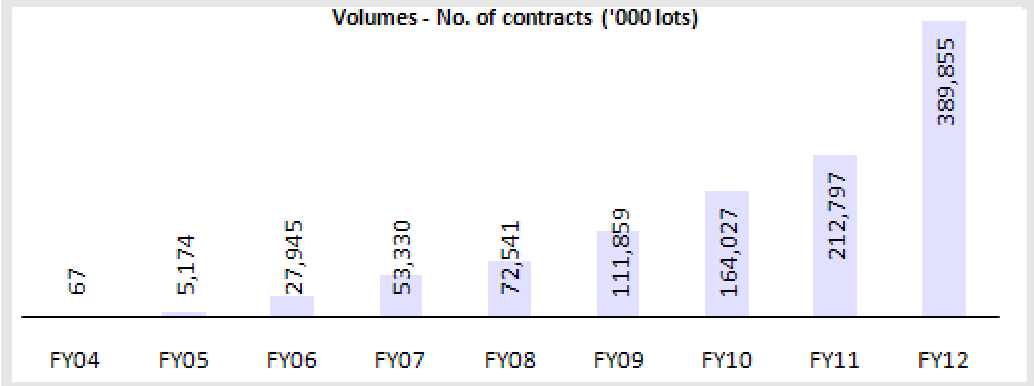
FCRA bill, if passed, will be a 3-fold push to volumes from introduction of: [1] Options, [2] New Product categories (indices), and [3] New Participants (FIIs, MFs, Banks)

The market still operates under the outdated Forward Contracts (Regulation) Act (FCRA), 1952. Many of the contracts that have gained global prominence did not exist in 1952. Within the constraints imposed by the existing statute, FMC's statutory powers are far below those required and expose the FMC to judicial challenge for its regulatory and just actions taken in the interest of the market and economy.

It is widely believed that the bill, which has been recommended by the Parliamentary Standing Committee of the Ministry of Consumer Affairs, Food and Public Distribution, on December 19, 2011, will be passed into law by the Parliament in the forthcoming session. Amendments to FCRA have been ready for many years now. The Amendment Bill will give the market's regulator, the FMC, the powers that befit a regulator of a major commodity market, and enable systematic development of the market. It will be a significant boost to volumes on following counts:

- **Introduction of options:** Options trading have witnessed huge potential in the global commodity markets. Globally, options trading contributed 48 per cent of the total futures and options volumes traded in CY 2011. Introduction of options trading in India would increase the commodity volumes manifold, and facilitate the participants with wider investment and hedging tools.
- **Introduction of new commodity classes:** If the trading of intangibles such as freight, rainfall and commodity indices is permitted, these new contracts could drive growth in the Indian commodity derivatives trading market.
- **Increased investor participation:** The GoI may consider permitting banks, mutual funds and foreign institutional investors (FIIs) to trade in India's commodity futures markets. This could drive two-pronged growth in volumes:
  - The hedgers would get access to a wide array of market makers, helping them to close larger contract sizes on Indian exchanges than on other exchanges.
  - We understand from the management that it would also provide the participants room for speculation. Currently, the regulations ensure that the trading by Indian players on foreign bourses is purely for risk-management purposes.

3rd largest exchange globally in CY11 (no. of contracts), despite limited participants and products



Source: Company, MOSL

Significant potential of value unlocking from MCX-SX; following the right approach

Sale of MCX-SX's warrants within next 3 years could unlock significant value

MCX-SX, promoted by MCX and FTECH, was recently cleared to become a full-fledged stock exchange. Like BSE and NSE, it can now start trading in equities, equity derivatives and other asset classes. Currently, MCX-SX only offers trading in currency futures contracts.

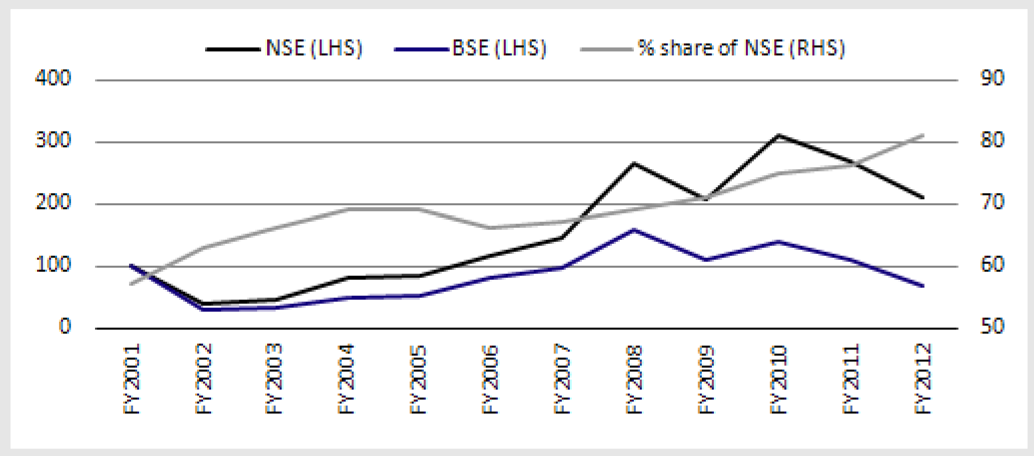
MCX-SX is currently focusing on roping in members to trade on the exchange. Stocks of companies can be traded without them being listed on MCX-SX, implying that the company's key thrust is on member additions. The process of adding members may take a couple of months, as the requisite approvals from SEBI take time. The exchange is expected to go live in the equities segment by November 2012.

The exchange recently launched currency options from 10th August after having completed four successful mock trading sessions. Within currency futures too, it had a leading market share of ~44% in FY12.

Will MCX-SX be able to gain share in the equities exchange? Does not need to look too far for a precedent

The Bombay stock exchange had a legacy of 132 years in India, a reliable brand, with the letters almost becoming synonymous with investing in India. However, all this was till NSE came onto the scene in 1992. Being a relatively new entity, NSE was nimbler and more receptive to innovation. While it was difficult for NSE to carve a niche initially, but quickly realizing the importance of IT and innovative products to meet the growing sophistication of the financial markets, NSE raced ahead to rule market share charts. How the share of it has continued to improve even after the shift of balance in power is reflected in the turnover metrics on the two exchanges since FY01.

Turnover at NSE has continued to exceed BSE (indexed at 100)



Source: Company, MOSL

Stock exchange is an area with ample scope for innovation and betterment in technology. MCX-SX, with its parentage of FTECH, has access to technology and management having experience of operating exchanges successfully across the globe.

Global peers valuation

	Sales - USD m			Mkt Cap	Price/Sales		
	CY11	CY12E	CY13E	USD m	CY11	CY12E	CY13E
NASDAQ OMX GROUP	3,438	1,661	1,741	3,946	1.1	2.4	2.3
LONDON STOCK EXCHANGE GROUP	1,300	1,326	1,465	4,092	3.1	3.1	2.8
DEUTSCHE BOERSE AG	3,294	2,785	2,916	9,741	3.0	3.5	3.3
SINGAPORE EXCHANGE LTD	517	562	619	5,711	11.0	10.2	9.2

Source: Bloomberg

If valuations of NSE and Singapore exchange are anything to go by ...

NSE received a valuation of INR171b in the last known stake sale that happened in December 2011, which discounted its FY12 revenues by 11x . This is at par with the Price/Sales ratio that Singapore enjoys. MCX-SX had revenues of INR391m in FY11. However, the levying of transaction charges in currency futures had commenced only from August 2011, implying that in FY12, the company had ~7 months of additional income in the form of transactional charges in FY12. Going by the volumes and rate card, this translates into ~415m of revenues from transaction charges, and even if we assume that other sources of income reduced as member additions may have fallen, FY12 revenue would still be higher than INR600m.

In FY13, revenue growth will be boosted further by: [1] residual impact of four more months of transaction income from currency futures, [2] income from operation of currency options, which started in August FY12 and [3] Income from equity operations, which are expected to launch around November 2012.

With the help of these, we see the exchange revenues easily cross INR1b in FY13. Annualizing the volumes for the first 5 months, we get revenues from currency futures alone at INR629m in FY13. This should surge further in FY14, which will be the first full year of operations in 2 out of the 3 segments. Given the low base and high growth, while the valuation multiple could be higher, we discount our FY14E revenue estimate of INR1.3b by 11x, to arrive at a valuation of INR14b. MCX's stake in MCX-SX (including warrants) amounts to INR5.4b.

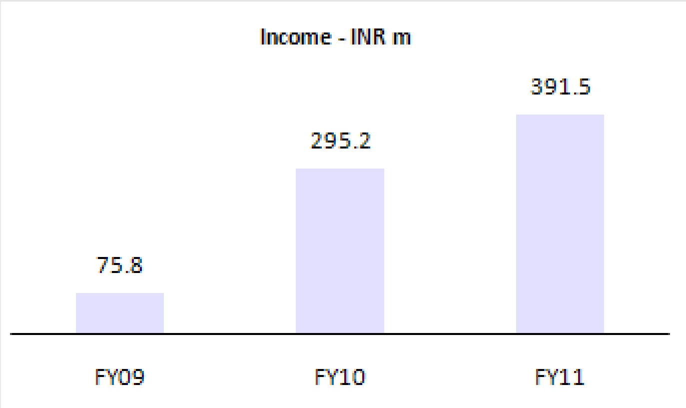
LSE's stake buy in DSE poses additional competitive threat to MCX-SX's equity operations ...

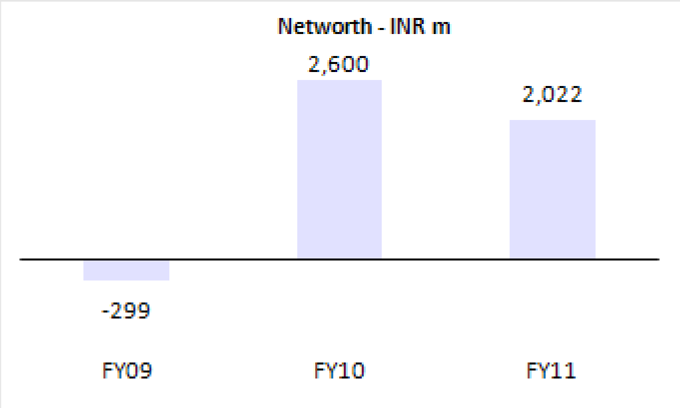
British bourse has picked up a five per cent stake in Delhi Stock Exchange (DSE) and aims to change the trading model by providing the fastest trading technology to the latter to take on the Indian market. This implies that the risk to growth for MCX-SX is not only from challenge of displacing the existing leaders, but also, fighting the parallel attempt to resurgence by DSE.

... but mitigated by presence in other investment classes

Currency futures and currency options are already being traded on the exchange. MCX-SX also cited significant market in interest rate derivatives in India, another segment which will remain its focus. We believe the company's strategy is the right one, as it adds members for these investment classes, and gradually growing its share in the equity business as well.

Revenue at MCX-SX expected to surge with transaction fees from FY12 and clearance to operate as full - fledged exchange





Source: MCX RHP

Modalities of MCX's holding in MCX-SX

Within the next 18 months, the shareholding of MCX and FTECH in MCX-SX will have to be reduced to ~2.5% each, as the approval is subject to the condition that the combined voting rights of FTECH and MCX in MCX-SX will not exceed 5%.

Earlier, FTECH held 31% and MCX held 38% in MCX-SX. Then, to comply with SEBI guidelines for starting equity trading, they reduced their stake in MCX-SX to 5% each. This was done through conversion of excess equity stake (beyond 10%) to warrants. This led to 68.2% reduction in capital from INR1.7b to INR0.54b. The warrants will be sold to banks and financial institutions.

Sustainable growth; value unlocking; healthy payout

Target price of INR1,440 implies 23% upside; Buy

- **MCX's volumes have grown at a CAGR of 47% over FY07-12. With the industry still nascent, growth potential remains huge as it adds [1] new participants, [2] volumes from existing participants.**
- **We expect higher volumes to translate into higher margins, aided by high operating leverage. We estimate increase in EBIT margin from 58.4% in FY12 to 61.6% in FY15.**
- **Decision to maintain payout ratio at ~50% is a key valuation positive. Also, superior growth potential, near-monopolistic market share and improving profitability make a case for premium valuations in standalone business. Besides, there is value unlocking potential from the warrants it holds in MCX-SX.**
- **Our target price of INR1,440 implies 23% upside. We initiate coverage with a Buy rating.**

Expect sustained double digit volume growth

MCX's volumes have grown at a CAGR of 47% over FY07-12. Volatility in different commodities at various points of time (gold, silver, crude and copper) and a low base have facilitated robust volume growth. However, volume growth for the first five months of the year is down 3.7% YoY. Given the drop in volatility index over the last couple of quarters, we assume flat volumes YoY in FY13. However, notwithstanding low volatility in the near term that is affecting volumes, we believe there is enough potential to grow volumes in double digits over the medium-to-long term.

Fixed/semi-fixed costs as a percentage of total expenditure (%)

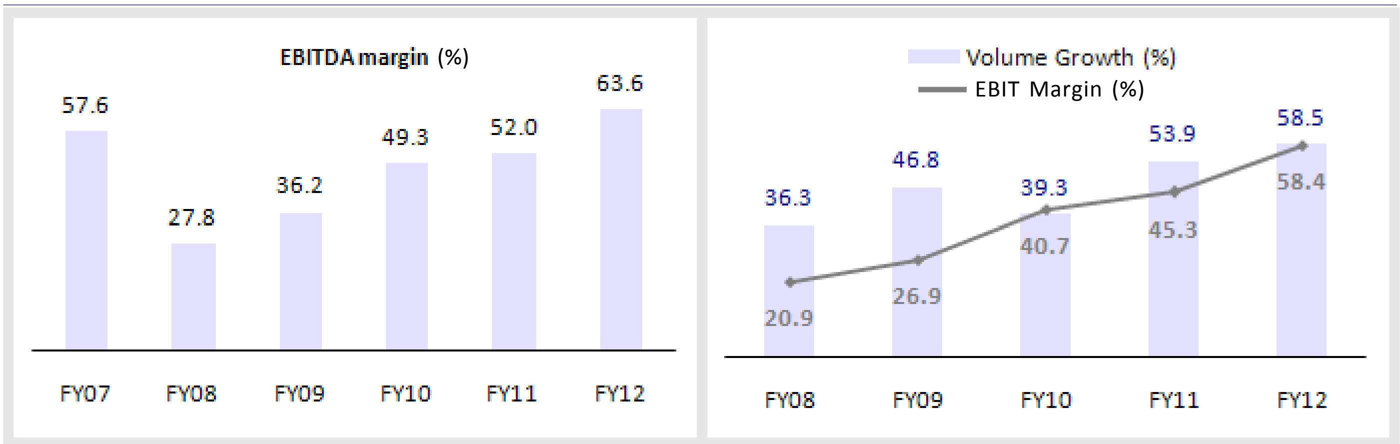
FY07	55.9
FY08	60.5
FY09	70.1
FY10	68.1
FY11	68.8
FY12	~70.0

Source: Company/MOSL

Margins to continue improving, aided by high operating leverage...

MCX's EBIT margin has improved from 20.9% in FY08 to 58.4% in FY12, aided by high operating leverage. A large proportion of MCX's costs is fixed/semi-fixed and is not dependent on the trading volumes on the exchange. These include software support charges, license fees, personnel costs and other administration costs like communication expenses, electricity charges, insurance, etc.

Higher volumes have facilitated better operating margins over the years



Source: Company/MOSL

...but lower yields, higher technical fees may limit extent of expansion

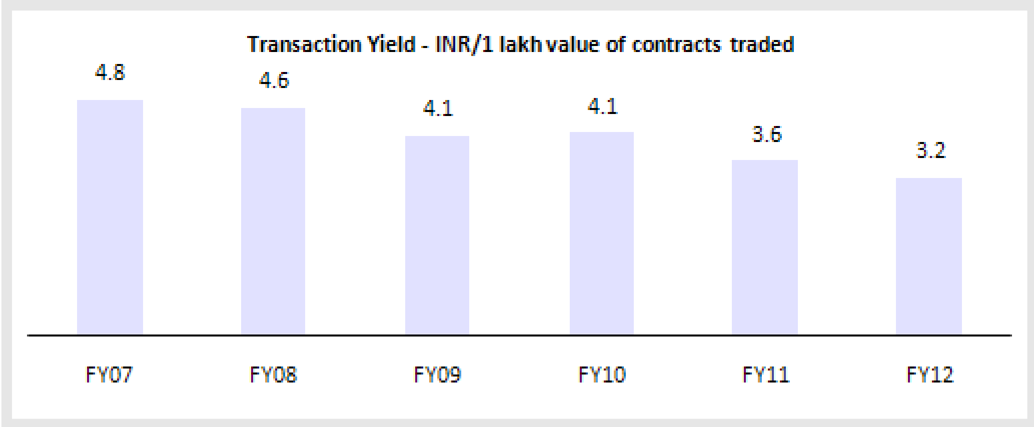
Increase in software services fees charged by the parent could impact the margin profile

While there is scope for further expansion in margins on higher volumes, given the exchange's scalability, we expect margin expansion to be limited by [1] lower transaction yields due to increase in bulk trades and competition, [2] possible increase in transaction fees to the parent for technology services. We expect EBIT margin over the long term to be 65%, comparable to global peers and also justified by the exchange's high operating leverage.

MCX rate card

Avg Daily Turn over	Transaction fee (per INR100k)
Upto INR2.5b	INR2.5
INR2.5b-10b	INR1.25
INR10b+	INR1.0

Transaction yields have been falling with higher number of bulk transactions



Source: Company, MOSL

Valuing standalone business at 20x FY14E earnings

We value MCX's standalone business at 20x FY14E, in-line with the average multiple to commodity exchanges in the emerging markets. We believe there is enough reason for MCX to even trade at a premium given: [1] scope to outgrow peer exchanges globally, given that the potential is still untapped in India, [2] higher growth will be augmented by even better earnings and improvement in return ratios (variable costs largely only in the form of transaction fees paid to parent), and [3] near-monopolistic market share, to which there is little threat, given MCX's technology backbone and readiness to latch on to new opportunities. We value MCX's standalone business at 20x FY14E EPS of INR66.5 – INR1,330.

MCX should trade at a premium to global peers, given its superior financials (%)

	2012-14	2012-14	EBITDA Margin			RoE			P/E (x)		
Company	Sales CAGR	EPS CAGR	2012	2013E	2014E	2012	2013E	2014E	2012	2013E	2014E
CME Group Inc	8.1	15.5	67.9	68.8	71.4	10.5	11.4	5.7	18.4	16.2	13.8
Intercontinental Exchange Inc	9.3	12.1	70.2	72.3	73.4	17.7	17.8	15.4	17.6	15.6	14.0
Multi Commodity Exchange India	**8.1**	**8.9**	**63.6**	**61.3**	**64.0**	**31.0**	**26.5**	**27.8**	**20.9**	**21.2**	**17.6**
Nasdaq OMX Group/THE	5.3	14.7	50.1	51.5	53.5	8.6	10.0	11.0	9.5	8.2	7.2
CBOE Holdings Inc	9.1	15.8	54.7	55.6	57.7	56.9	55.2	44.7	18.0	15.7	13.4
London Stock Exchange Group	9.5	2.2	58.5	55.1	54.3	21.2	16.6	17.1	10.6	11.0	10.2
TMX Group Inc	11.9	18.9	53.5	51.8	51.5	14.9	14.9	12.2	15.5	13.0	11.0
Deutsche Boerse AG	5.2	9.4	55.0	56.4	55.9	24.6	24.7	24.6	10.8	9.6	9.1
Bolsas Y Mercados Espanoles	-0.5	-2.0	67.0	66.3	65.2	31.9	30.5	28.9	10.3	10.4	10.7
ASX Ltd	4.9	4.5	77.2	77.0	77.3	11.4	11.7	12.4	15.5	15.2	14.2
Singapore Exchange Ltd	7.4	9.0	61.2	61.3	63.3	36.2	37.9	40.7	**24.5**	**22.9**	**20.6**
Hong Kong Exchanges & Clear	9.9	9.2	71.5	73.4	74.3	44.6	44.7	43.0	**26.2**	**23.9**	**21.9**
Bursa Malaysia BHD	8.8	10.6	57.2	58.3	59.3	17.4	19.0	20.3	**21.4**	**19.1**	**17.5**

Source: Bloomberg

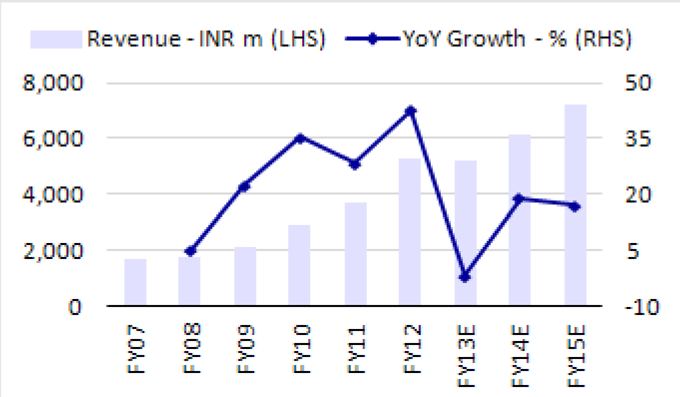
Adding potential value from MCX-SX; Buy with a TP of INR1,440, 23% upside

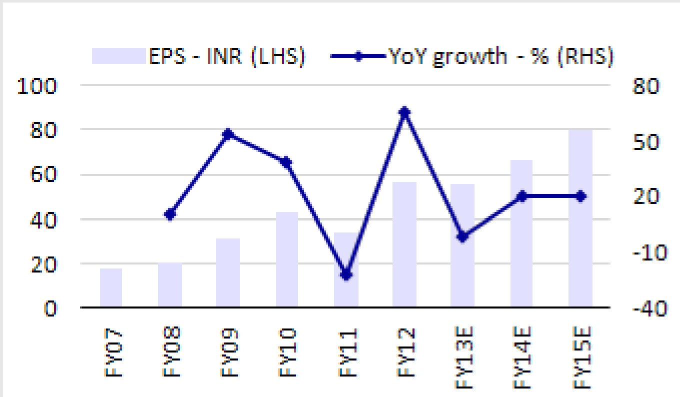
While we value MCX's standalone business at INR1,330, we separately assign a value to MCX's stake in MCX-SX (including warrants). The transactions in MCX-SX stake that happened in FY10 valued the exchange at ~INR45b. The latest transaction in National Stock Exchange of India (NSE) stake valued NSE at INR171b.

Assuming a revenue base of INR1.3b in FY14, at 11x FY14 Sales, MCX-SX's valuation is INR14b (much lesser than that implied in the last stake sale). Stake in MCX-SX (including warrants) contributes additional INR110 per share to MCX. Our target price is thus, INR1,440 (INR1,330 for standalone business + INR110 for warrants in MCX-SX). **Buy** for 23% upside.

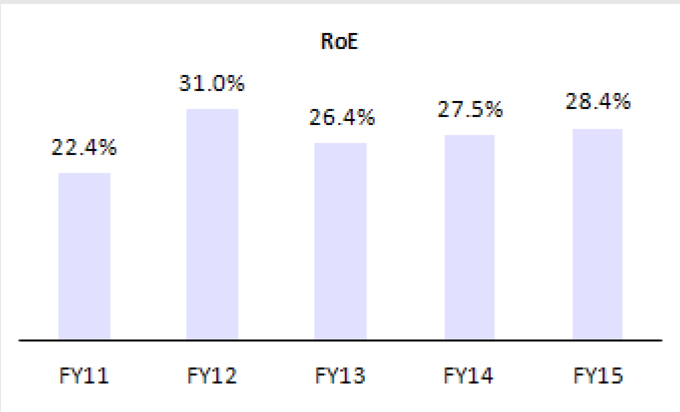
We expect volumes CAGR of 15% over FY12-15 and a PAT CAGR of 13% over this period. Also, the ROE should sustain its level in the high 20's. The company's decision to maintain its payout ratio at ~50% in the future too is a key valuation positive, and will support high multiples.

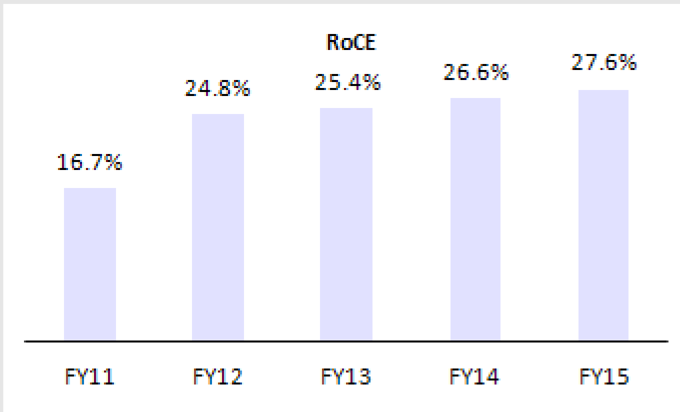
Blip in revenue and EPS growth in FY13 expected due to low volume growth on high FY12 base and volatility drop





Expect return ratios to remain high





Source: Company, MOSL

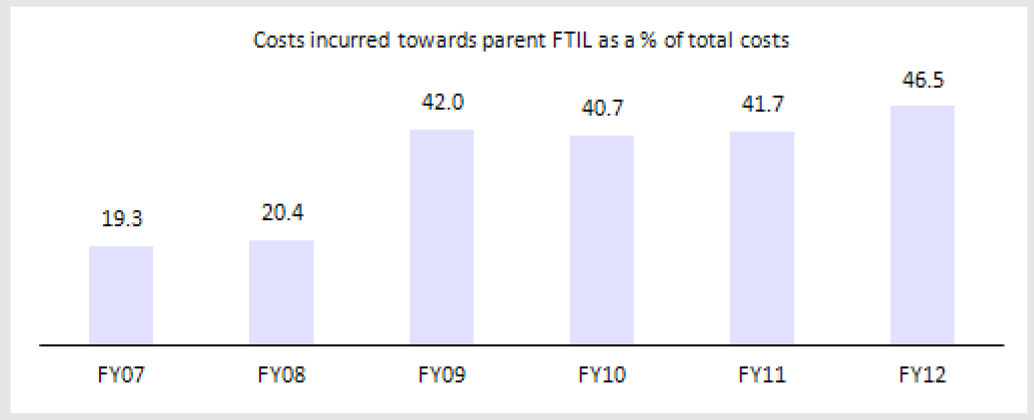
Key risks

Significant proportion of costs incurred towards parent and group companies

The Technical services agreement with the parent FTIL is likely to come up for discussion again in FY13

Over 40% of MCX's operating costs are towards various fees paid to the parent, FTECH and promoter group companies. Its technical services agreement (TSA) with FTECH for IT infrastructure and software services, which costs MCX 12.5% of its transaction fees in addition to a fixed charge of INR120m per annum, constitutes a major portion of operating costs. Costs that are incurred towards FTECH have gone up from ~19% of operating expenses in FY08 to ~47% in FY12. Also, the variable fee was revised upwards to 12.5% in FY11, from 10% before that, and will come up for discussion again this year.

Fees to FTECH under TSA increasing as a percentage of costs



Source: Company, MOSL

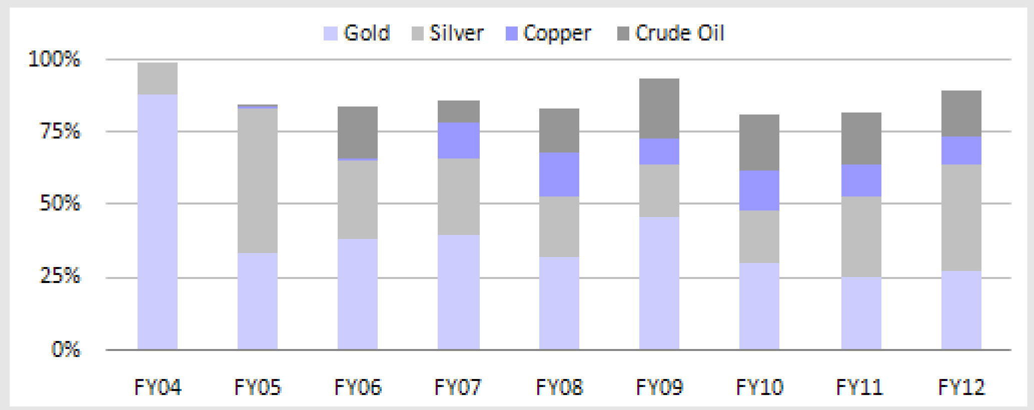
Given that FTECH's ownership in MCX is the minimum when compared to its holdings in other group companies, the overhang of increase in technical services fee (as a percentage of transaction fee) could be potential threat to MCX's profitability.

Concentration of turnover in four commodities

Declining volumes of trading in Gold and Silver have so far limited the growth in overall volumes at the exchange in FY13

The aggregate value of commodity futures traded at MCX has been concentrated mainly in four commodities – gold, silver, copper and crude oil. During FY04-12, 83-94% of the total traded value has been from these four commodities. Any period of parallel inaction in terms of volumes on any counter would impact overall volumes adversely. April 2012 was one instance – volumes in gold, silver and crude were down MoM, and 12.2% MoM increase in copper volumes could not offset the 17.5% MoM decline in overall value of contracts traded on the exchange.

Four commodities currently dominate the turnover at MCX



Source: Company, MOSL

Regulatory paralysis could impact growth

In the current regulatory environment, foreign institutional investors, banks and mutual funds cannot trade on commodity exchanges. Also, trading in options on commodity futures is prohibited in India. While the possible passage of the FCRA Bill could boost MCX's volumes and provide a sentimental fillip to the stock, there is a risk that the amendments may not be enforced in a timely manner.

Sharp fall in commodity prices

Trading volumes on the exchange are dependent on volatility in commodity prices, which may in turn be dictated by the directional movement in commodity prices. A number of factors outside the control of the company could impact volatility, and as a result, volumes on the exchange.

About MCX

A state-of-the-art electronic commodity futures exchange

Headquartered in Mumbai, Multi Commodity Exchange of India Limited (MCX) is a state-of-the-art electronic commodity futures exchange. It has permanent recognition from the Government of India (GoI) to facilitate online trading, and clearing and settlement operations for commodity futures.

MCX began operations in November 2003, and has over 86% share (as at 31 March 2012) of the Indian commodity futures market. It has more than 2,170 registered members operating through over 346,000 trading terminals (including CTCLs), spread over 1,577 cities and towns across India. MCX was the third largest commodity futures exchange in the world in terms of the number of contracts traded in CY11.

MCX offers 49 commodities across segments such as bullion, ferrous and non-ferrous metals, energy, and a number of agri-commodities on its platform. It introduces standardized commodity futures contracts on its platform, providing an anonymous trading environment for price discovery. It is the world's largest exchange for silver and gold, the second largest for natural gas, and the third largest for crude oil, in terms of the number of futures contracts traded.

MCX has been at the forefront of commodities exchange development in India, with many firsts:

- MCX was the first exchange in India to initiate evening sessions to synchronise with the trading hours of global exchanges in London, New York and other major international markets.
- It was the first exchange in India to offer futures trading in steel, crude oil, and almonds.
- In June 2005, MCX launched MCXCOMDEX, India's first real time composite commodity futures index, which provides members with information regarding market movements in key commodities, as determined by physical market size in India, which are actively traded on MCX.
- In December 2009, it launched EFP transactions for the first time in India, enabling parties with futures positions to swap their positions in the physical markets and vice versa.

Technology

MCX's operations are sustained by the exchange related support infrastructure and software that it sources from its promoter, Financial Technologies India (FTECH). Technology for the exchange industry is difficult to replicate, thus providing it with a competitive advantage. The company has made significant investments in developing fixed operating infrastructure, including technology systems, to support anticipated growth and increase in the demand for its products. Its technology platform and business model are highly scalable and have the potential to generate better margins at greater volumes. Its current technology infrastructure is sufficient to handle daily trading volumes of up to 10m. So far, it has handled a high of 1.9m trades in a day.

Membership

Members are classified into four general categories:

- Trading members (TMs) have rights to trade on their own account as well as on account of clients. However, TMs have no right to clear and settle such trades.
- Trading-cum-clearing members (TCMs) are entitled to trade on their own account as well as on clients' account. TCMs can also clear and settle trades themselves.
- Institutional trading cum clearing members (ITCMs) are entitled to trade on their own account as well as on account of their clients, clear and settle trades executed by themselves as well as of trading members and trading cum clearing members.
- Professional Clearing Members (PCMs) are entitled only to clear and settle trades executed by trading-cum clearing members or trading members.

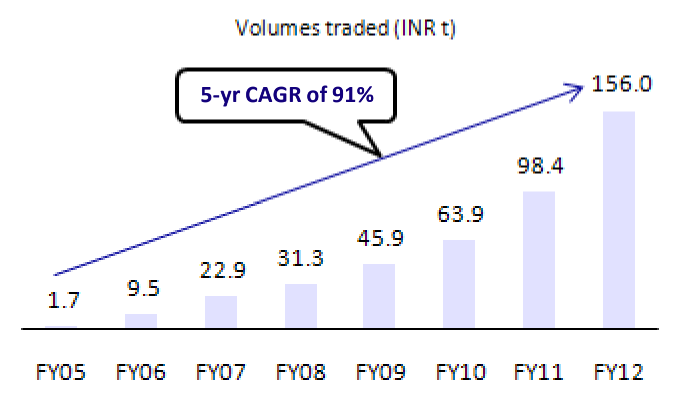
Membership fee structure

	Trading Member	**Non-Deposit Based TCM**	**Deposit-Based TCM**	**Institutional Trading cum Clearing Member (ITCM)**	**Professional Clearing Member (PCM)**
Eligible Entities	Individuals (including sole proprietorships), registered partner-ship firms, corporate bodies and Hindu Undivided Families (HUFs).	Sole proprietors, partnership firms, HUFs, companies, co-operative societies, public sector organiza--tions, statutory organizations or any other Government or non-Government entities	Sole proprietors, partnership firms, HUFs, companies, co-operative societies, public sector organiza--tions, statutory organizations or any other Government or non-Government entities	Companies, institutions	Companies, institutions
Admission Fees	INR750k	INR2,500k	INR1,000k	INR2,500k	INR1,000k
Security Deposit	PCMs and ITCMs shall collect deposits from Trading Members	INR3,000k	INR6,500k	INR10,000k	INR10,000k
Annual Subs.	INR10k	INR75k	INR75k	INR100k	INR100k
Processing Fees	INR10k	INR10k	INR10k	INR10k	INR10k
VSAT Deposit Min. monthly	INR165k	INR165k	INR165k	INR165k	INR165k
Terminal fees	INR1k	INR1k	INR1k	INR1k	INR1k
Min. Networth	Corporate: INR2500k Non-corporate: INR1,000k	INR7,500k	INR7,500k	INR10,000k	INR50,000k
Authorized activities	Have rights to trade on their own a/c as well as on a/c of their clients	Entitled to trade on their own account as well as on account of their clients, and clear and settle these trades themselves	Entitled to trade on their own a/c as well as on account of their clients, and clear and settle these trades themselves	Entitled to trade on their own account as well as on account of their clients, clear and settle trades executed by themselves as well as TMs and TCMs of the Exchange	Entitled to only clear and settle trades executed by TMs and TCMs of the Exchange
Transferability of membership/ refund	Membership transferable after three years	Membership transferable after three years	Deposit refundable after three years	Deposit refundable after three years	Deposit refundable after three years

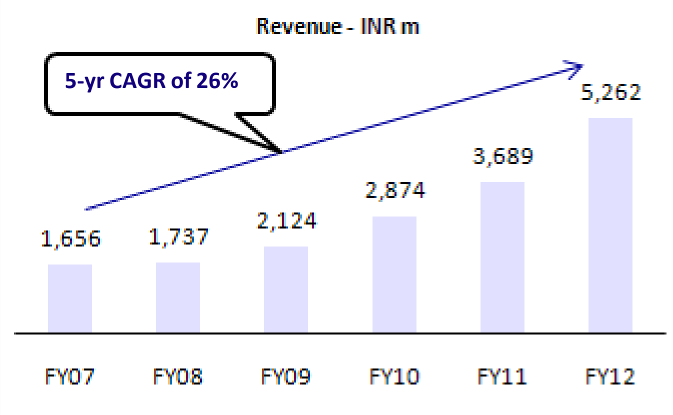
Source: MCX RHP

Operating performance snapshot

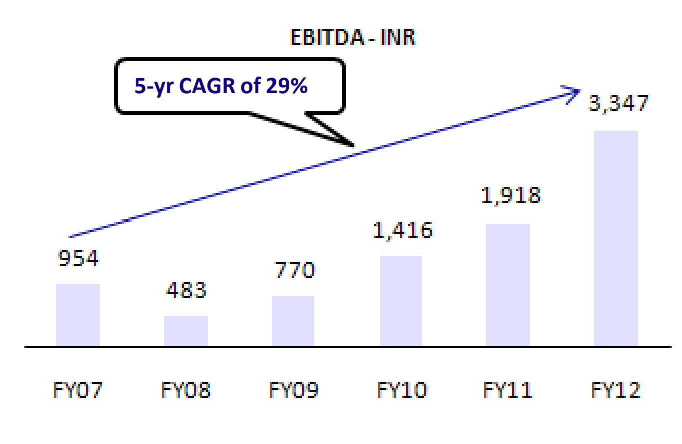
Volume traded (INR t)



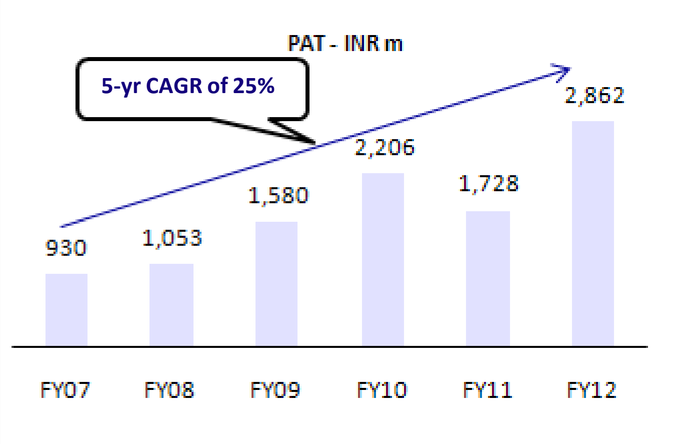
Revenue (INR m)



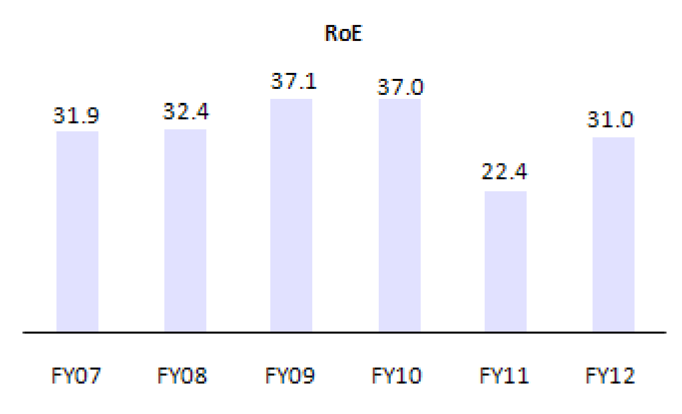
EBITDA (INR)



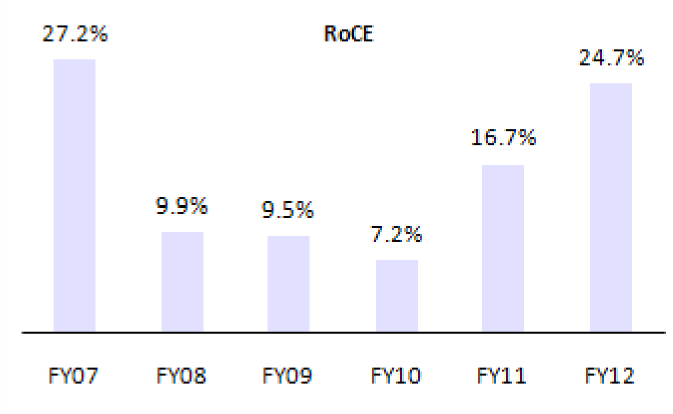
PAT (INR m)



RoE (%)



RoCE



Source: Company, MOSL

Financials and Valuation

Income Statement (INR Million)

Y/E March	2010	2011	2012	2013E	2014E	2015E
Sales	2,874	3,689	5,262	5,172	6,152	7,200
Change (%)	35.3	28.4	42.6	(1.7)	19.0	17.0
Cost of Services	218	264	280	340	368	386
SG&A Expenses	1,240	1,507	1,635	1,661	1,846	2,016
EBITDA	**1,416**	**1,918**	**3,347**	**3,171**	**3,939**	**4,798**
% of Net Sales	49.3	52.0	63.6	61.3	64.0	66.6
Depreciation	247	247	272	285	338	360
Other Income	2,062	784	1,027	1,044	1,113	1,216
EO Item (net)	-	-	142	-	-	-
PBT	**3,230**	**2,455**	**3,960**	**3,930**	**4,714**	**5,654**
Tax	1,024	727	1,098	1,106	1,320	1,583
Rate (%)	31.7	29.6	27.7	28.1	28.0	28.0
PAT	**2,206**	**1,728**	**2,862**	**2,824**	**3,394**	**4,071**
Net Income	2,206	1,728	2,862	2,824	3,394	4,071
Change (%)	39.6	(21.7)	65.6	(1.3)	20.2	19.9

Balance Sheet

Y/E March	2010	2011	2012	2013E	2014E	2015E
Share Capital	408	510	508	508	508	508
Reserves	6,562	7,975	9,461	10,836	12,543	14,468
Net Worth	**6,970**	**8,485**	**9,969**	**11,343**	**13,051**	**14,976**
Loan and other long term liabilities	106	127	432	432	432	432
Capital Employed	**7,076**	**8,612**	**10,401**	**11,776**	**13,483**	**15,408**
Net Block	**1,925**	**1,953**	**1,369**	**1,387**	**1,299**	**1,189**
CWIP	3	0	1	1	1	1
Other LT Assets	-	-	1,907	1,907	1,907	1,907
Investments	-	-	2,208	2,208	2,208	2,208
Curr. Assets	**10,362**	**13,044**	**13,274**	**14,546**	**16,235**	**18,642**
Current Investments	6,172	8,236	9,294	9,294	9,294	9,294
Debtors	304	489	514	686	817	957
Cash & Bank Balance	2,700	3,310	3,124	4,109	5,579	7,753
Loans & Advances	1,108	897	283	381	454	531
Other Current Assets	78	113	59	76	91	106
Current Liab. & Prov	**5,214**	**6,385**	**8,358**	**8,275**	**8,167**	**8,539**
Net Current Assets	**5,148**	**6,659**	**4,916**	**6,272**	**8,068**	**10,103**
Application of Funds	**7,076**	**8,612**	**10,401**	**11,776**	**13,483**	**15,408**

E: MOSL Estimates

Financials and Valuation

Ratios

Y/E March	2010	2011	2012	2013E	2014E	2015E
Basic (INR)						
EPS	**43.2**	**33.9**	**56.1**	**55.4**	**66.5**	**79.8**
Cash EPS	48.1	38.7	61.4	61.0	73.2	86.9
Book Value	136.7	166.4	195.5	222.4	255.9	293.7
DPS	4.0	5.0	24.0	25.0	28.0	34.0
Payout %	10.8	17.1	50.0	52.8	49.2	49.8
Valuation (x)						
P/E			20.9	21.2	17.6	14.7
Cash P/E			19.1	19.3	16.0	13.5
EV/EBITDA			14.3	14.7	11.5	9.0
EV/Sales			9.1	9.0	7.4	6.0
Price/Book Value			6.0	5.3	4.6	4.0
Dividend Yield (%)			2.4	2.5	2.8	3.4
Profitability Ratios (%)						
RoE	37.0	22.4	31.0	26.5	27.8	29.0
RoCE	7.2	16.7	24.8	25.5	26.9	28.2
Turnover Ratios						
Debtors (Days)	38.6	48.4	35.7	45.0	45.0	45.0
Fixed Asset Turnover (x)	24.0	27.0	31.2	26.7	29.5	31.6

Cash Flow Statement

Y/E March	2010	2011	2012	2013E	2014E	2015E
CF from Operations	1,101	1,619	1,600	2,107	2,603	3,097
Cash for Working Capital	(2,013)	1,080	1,160	(371)	(326)	140
Net Operating CF	**(912)**	**2,700**	**2,760**	**1,736**	**2,277**	**3,237**
Net Purchase of FA	(87)	(286)	(200)	(300)	(250)	(250)
Net Purchase of Invest.	(42)	(2,042)	(2,723)	1,040	1,113	1,216
Net Cash from Invest.	**(129)**	**(2,328)**	**(2,923)**	**740**	**863**	**966**
Dividend Payments	(239)	(238)	(296)	(1,492)	(1,671)	(2,029)
Cash Flow from Fin.	**(239)**	**(238)**	**(296)**	**(1,492)**	**(1,671)**	**(2,029)**
Free Cash Flow	(1,000)	2,414	2,561	1,436	2,027	2,987
Net Cash Flow	(1,280)	134	(459)	985	1,470	2,174
Opening Cash Bal.	**1,764**	**484**	**624**	**165**	**1,150**	**2,620**
Add: Net Cash	(1,280)	134	(459)	985	1,470	2,174
Closing Cash Bal.	**484**	**624**	**165**	**1,150**	**2,620**	**4,794**

E: MOSL Estimates

Disclosures

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