

OTC Markets Group

Record quarterly revenues and a special dividend

Q314 results

Financial services

OTC Markets Group (OTCQX: OTCM) provides regulated marketplaces offering a cost-effective solution for targeting US investors. Q314 gross revenues rose 21% compared with Q313, driven by a 36% increase in Market Data Licensing revenue from re-pricing and an increase in subscribers. This led to a 53% increase in operating profits and a 35% y-o-y increase in net income. The company announced a special Q3 dividend of US\$0.5 in addition to a usual Q3 dividend of US\$0.1.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/12	33.2	9.0	50.5	20.0	28.5	1.4
12/13	33.6	8.3	50.8	24.0	28.4	1.7
12/14e	39.5	12.4	63.0	86.0	22.8	6.0
12/15e	43.7	15.5	81.5	46.0	17.7	3.2

Note: PBT and EPS are normalised and exclude exceptional items and amortisation of intangibles.

Q314 Market Data Licensing (MDL) revenue up 36%

Q314 MDL revenue rose 36% compared with Q313. From 1 January 2014 OTCM's new MDL pricing came into effect; 60% of the revenue increase derived from the price increases and the other 40% arose from expansion of the distribution network and number of end-users. This revenue, which now amounts to almost 50% of group revenue, is proprietary OTCM information and should be recurring, and growing.

Growth in OTCQB Venture Marketplace

OTCM has reported that its premium OTCQB Venture Marketplace for entrepreneurial- and development-stage companies has been well accepted, with 153 companies having met the required standards by 31 October 2014 and a strong order book of OTCQB applications. The company believes there is considerable potential for this marketplace, as for the first time it offers US venture companies an effective market for their shares to be traded.

Large dividend increase

OTCM announced a special US\$0.5 per share Q3 dividend as well as a usual quarterly dividend of US\$0.1. It has no outstanding debts and the dividend payments reflect its determination to follow shareholder-friendly policies and return excess capital to investors.

Valuation: Good dividend yield

The shares have rallied 90% since the start of this year and at US\$14.4 are now closer to our \$16.6 per share valuation (excluding Q4 dividend payments) based on cash flow considerations. A feature of the company is its high dividend yield, reflecting its shareholder-friendly attitude towards surplus capital in the company.

27 November 2014

Price **US\$14.4**
Market cap **US\$159m**

Net cash (\$m) at 30 September 2014	19.1
Shares in issue (excluding treasury)	11.05m
Free float	60%
Code	OTCM
Primary exchange	OTCQX
Secondary exchange	N/A

Share price performance



Business description

OTC Markets Group (OTCM) operates the OTCQX, OTCQB and OTC Pink financial marketplaces for 10,000 US and global securities. Its trading system OTC Link ATS is operated by OTC Link LLC, a member of FINRA/SIPC and SEC regulated ATS.

Next event

FY14 results	Early March 2015
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Q314 results

Exhibit 1: OTCM Q314 results

\$000s	Q313	Q214	Q314	Q314 on Q214 %	Q314 on Q313 %
OTC Link ATS Trading services	2,815	2,772	3,146	13	12
Market Data Licensing	3,778	5,148	5,123	0	36
Corporate services	2,367	2,319	2,530	9	7
Gross revenues	8,960	10,239	10,799	5	21
Re-distribution fees and rebates	(477)	(581)	(593)	2	24
Net revenue	8,483	9,658	10,206	6	20
Operating expenses (exc depreciation and amortisation)	(5,820)	(6,609)	(6,351)	(4)	9
Depreciation and amortisation	(403)	(373)	(408)	9	1
Income from operations	2,260	2,676	3,447	29	53
Other income / net interest	1	6	1	(83)	0
Income before provision for income taxes	2,261	2,682	3,448	29	52
Taxes	(829)	(1,063)	(1,511)	42	82
Net income	1,432	1,619	1,937	20	35

Source: OTCM

OTCM reported another strong quarter of revenue growth in Q314 with gross revenues rising 21% y-o-y and 5% q-o-q. There was particularly strong growth in Market Data Licensing, which increased revenue 36% y-o-y, although this was flat in the quarter. The increase in revenue led to a 53% y-o-y increase in income from operations and a 29% increase q-o-q. Net income increased at a lower rate, 35% y-o-y and 20% q-o-q as the Q314 effective tax rate rose to 44% from 37% in Q313 and 40% in Q214 as R&D tax credits have not yet been enacted in 2014.

Market Data Licensing (\$5.1m, 47% of Q314 revenue)

OTCM's market data distribution network includes all the major financial data distributors and online brokerage firms. With effect from Q114, OTCM re-priced its MDL fees and this accounted for around 60% of the year-on-year revenue increase in Q314, with the remainder due to a further rise in the subscription base with professional user licences rising 12% y-o-y. Q314 revenue from MDL was flat compared with Q214 as there was a decrease in non-professional user licences and advertising revenue as a result of lower trading activity in that quarter compared with earlier in the year which resulted in a decline in non-professional users.

OTC Link ATS trading services (\$3.1m, 29% of Q314 revenue)

OTC Link ATS Trading Services links US broker-dealers and so provides liquidity and execution services for US and global equities. It enables FINRA member broker-dealers to display prices, attract order flow and conduct trade negotiations in equity and debt securities through a suite of quotation and trade-messaging products. Q314 revenue from OTC Link ATS trading services rose \$331,000 or 12% y-o-y in the quarter to \$3.1m. The increase arose as follows:

Exhibit 2: OTC Link ATS revenue increase Q314 compared with Q313

	\$000s	% change y-o-y
Updated FIX connection pricing schedule, net internet connection charges and increased OTC Dealer licence fees	404	44
Decline in QAP service fees	(35)	(24)
Other items	(38)	
Total	331	12

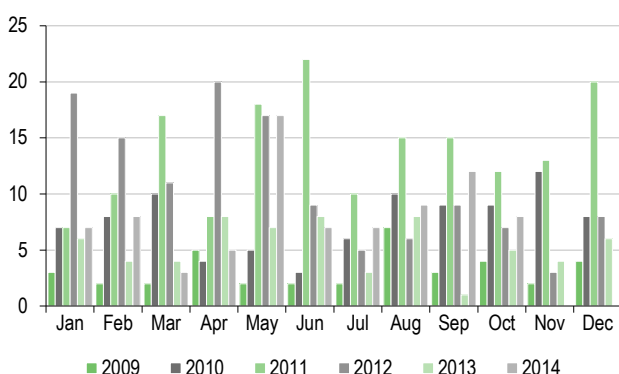
Source: OTCM

The fall in QAP service fees arose as a result of a decline in the number of shares traded above \$1.00 by the broker-dealer subscribers.

Corporate services (\$2.5m, 23% of Q314 revenues)

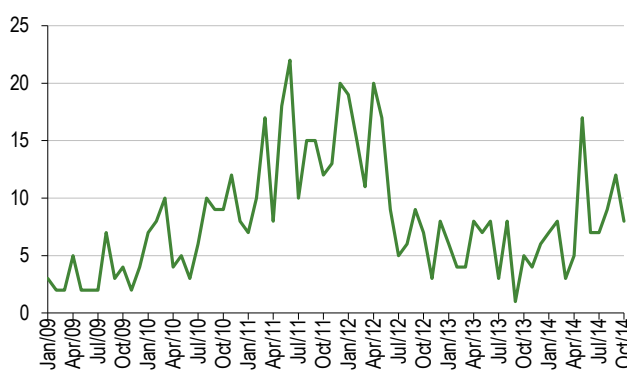
Q314 saw a welcome increase in revenue from Corporate Services of \$163,000 or 7% y-o-y after several periods of flat revenue. Some \$142,000 of the increase arose from 118 OTCQB subscribers paying the new subscription fees under the OTCQB standards launched on 1 May 2014, while premium service subscription revenue rose \$114,000, 13%, primarily due to improved retention efforts, growth in the number of corporate clients subscribing to the OTC Disclosure & News Service and increased subscriber use of integrated third-party newswire providers. These increases were partly offset by a decrease in OTCQX subscription revenue of \$92,000, 6%, primarily due to the lower number of OTCQX companies.

Exhibit 3: New customers by month (OTCQX)



Source: OTC Markets, Edison Investment Research

Exhibit 4: Monthly progression new OTCQX customers



Source: OTC Markets, Edison Investment Research

Exhibit 5: Summary of companies listed by marketplaces

Number of securities	Dec 2009	Dec 2010	Dec 2011	Dec 2012	Dec 2013	14 Nov 2014
OTCQX US	17	21	29	44	38	
OTCQX Int	61	138	285	356	332	
OTCQX total	78	159	314	400	370	380
OTCQB*	3,321	3,851	3,625	3,401	3,143	2,354
OTC Pink (total)	5,879	5,954	6,227	6,173	6,498	7,163
Total	9,278	9,964	10,166	9,974	10,011	9,897

Source: OTCM (www.otcm Markets.com/research/companyDirectory), Edison Investment Research. Note:

*Actual launch April 2010.

Business update

OTCQB

OTCM introduced new standards for the OTCQB marketplace, which came into effect on 1 May 2014. The standards are designed to raise the credibility of the marketplace with investors, with more requirements on issuers. It will move from a purely domestic, non-fee marketplace to a global premium one, charging fees and requiring traded companies to provide additional information to investors. The new OTCQB marketplace standards include minimum bid price standards that will migrate sub-penny securities to the OTC Pink marketplace. Additionally, companies subject to bankruptcy will no longer be able to trade their securities on OTCQB. Corporate managements will also need to certify that certain disclosures are correct. The new OTCQB standards must be met by 120 days after the companies' fiscal year ends, and as most OTCQB companies have fiscal years that end on 31 December, we expect the majority of the revenue impact in 2015.

In addition to its current base of SEC-reporting companies and banks, OTCQB is now open to international venture-stage companies. Management estimates that three-quarters of venture-stage companies listed on TSX Venture, LSE AIM and other non-US venture exchanges do not meet OTCQX's standards, and so opening OTCQB to them materially widens the potential issuer base.

The financial effects could be material. For new customers, the tariff will be a joining fee of \$2,500 with an annual fee of \$10,000. Existing OTCQB customers have been offered a discounted rate of \$7,500 for the first two years and a waiver of the admission fee. If all the current OTCQB customers converted, this would generate annual income of c \$20m, which compares with total corporate services revenue of \$9.3m for 2013. The conversion rate of existing customers to the new premium marketplace will be key to revenue uplift. By 30 September 2014 118 OTCQB companies had already moved to the premium service, with this number having risen to 175 by 10 November 2014.

OTCQX Banks

On 7 March 2014 OTCM announced the creation of a new marketplace for community and regional banks. OTCQX Banks launched on 21 May 2014 and its key features include:

- Enhanced visibility with investors, depositors and the community, leveraging the perceived brand value of OTCQX.
- Transparent disclosure with less complexity – banks can leverage their existing financial reports and regulatory filings with OTCM, ensuring financials are promptly distributed, readily available and easily researchable.
- Dedicated capital market support – banks can now appoint a principal ‘corporate broker’ as their OTCQX advisor, providing access to institutional investors, trading expertise and investment banking services.
- Peer benchmarking – OTCQX Banks will also serve as a baseline for a new community bank index to provide a more accurate benchmark for the performance of small- and mid-sized banks across the nation.

Over 600 community and regional banks already trade on the OTCQB marketplace, and we expect these to be initially targeted to earn the incremental fees from the increased functionality of OTCQX Banks. To qualify for OTCQX, banks must appoint a corporate broker that is a FINRA member and specialises in trading in and advising banks. At launch, some six brokers were approved by OTCM to act as corporate brokers to banks, including KBW. It may also be expected that the development of closer relationships with corporate brokers will be a source of introduction for new business in due course. By 10 November 2014, 25 regional community banks had qualified for OTCQX and the number of brokers had expanded to nine, with Raymond James added to the list.

Valuation

On our estimates, OTCM is trading on a 2015e P/E of c 18x, higher than the 16x of the US equity market. OTCM is a unique company, so peer comparisons to assess its value are not straightforward. Around 50% of its revenues are earned selling its data and a large proportion of its trading services and corporate service fees are earned on a subscription basis rather than on the number of trades, as at an investment bank or an exchange. Moreover, unlike the former it does not have position risk. Financial services information providers such as Markit and MSCI are trading on forward P/Es of over 20x, so OTCM is not as highly rated in P/E terms.

Long-term valuation techniques depend crucially on long-term growth assumptions. Prospective net cash is US\$13.5m at the end of 2014 (after paying the Q3 quarterly and special dividends), and with an expected c US\$10m of free cash flow in 2015, OTCM would be worth US\$16.6 per share on a DCF basis if we assume a long-term growth rate of 3% and a cost of capital of 9%.

Financials

We have fine-tuned our forecasts following the publication of Q3 results, as shown below.

Exhibit 6: OTCM earnings revisions

	Revenue (\$m)			PBT (\$m)			EPS (c)			Dividend (c)		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
2014e	39.2	39.5	1	11.8	12.4	5	62.5	63.0	1	36.0	86.0	139
2015e	44.7	43.7	(2)	15.4	15.5	0	81.5	81.5	0	46.0	46.0	0

Source: Edison Investment Research, OTC Markets

The main change to our forecasts is the dividend for 2014, which we have increased by 50c following the company's announcement that it will pay a special dividend for Q314 of 50c as well as the usual 10c dividend for that quarter.

Exhibit 7: Financial summary

\$000s	2011	2012	2013	2014e	2015e
Year end 31 December					
PROFIT & LOSS					
OTC Link ATS Trading Services	11,773	11,640	11,437	11,920	12,825
Market data licensing	13,680	14,081	14,741	20,430	21,900
Corporate services	7,498	9,305	9,331	9,508	11,550
Re-distribution fees and rebates	(1,944)	(2,168)	(2,188)	(1,842)	(1,869)
Revenue	30,763	33,184	33,640	39,481	43,685
Cost of Sales	(22,299)	(22,606)	(23,700)	(25,567)	(26,500)
Gross Profit	8,464	10,578	9,940	13,914	17,185
Operating Profit (before GW and except.)	8,464	10,578	9,940	13,914	17,185
Intangible Amortisation & depreciation	(1,358)	(1,622)	(1,642)	(1,561)	(1,720)
Operating Profit	7,106	8,956	8,298	12,353	15,465
Net Interest	(115)	30	0	8	0
Profit Before Tax (norm)	6,991	8,986	8,298	12,361	15,465
Tax	(2,139)	(3,509)	(2,667)	(5,215)	(6,186)
Profit After Tax (norm)	4,791	5,361	5,466	6,981	9,114
Profit After Tax (FRS 3)	4,852	5,477	5,631	7,146	9,279
Average Number of Shares Outstanding (m)					
EPS - normalised (\$)	0.45	0.51	0.51	0.63	0.81
EPS - FRS 3 (\$)	0.46	0.51	0.51	0.64	0.84
Dividend per share (\$)	0.16	0.20	0.24	0.86	0.46
Gross Margin (%)					
	28%	32%	30%	35%	39%
EBITDA Margin (%)					
	28%	32%	30%	35%	39%
Operating Margin (before GW and except.) (%)					
	28%	32%	30%	35%	39%
BALANCE SHEET					
Fixed Assets					
Intangible Assets	291	291	291	291	291
Tangible Assets	5,143	5,066	4,184	4,054	3,884
Investments	209	209	210	210	210
Current Assets					
Debtors	7,194	6,481	4,980	5,300	5,843
Cash & cash investments	10,170	13,611	18,936	13,479	18,539
Current Liabilities					
Creditors	(3,695)	(3,589)	(3,909)	(2,985)	(3,008)
Long Term Liabilities					
Deferred rent	(926)	(786)	(608)	(508)	(508)
Other long term liabilities	(1,598)	(1,176)	(974)	(933)	(933)
Net Assets	12,872	14,515	18,704	17,204	22,613
NAV per share (\$)	1.21	1.34	1.70	1.55	2.02
CASH FLOW					
Operating Cash Flow (pre-tax)	11,086	12,175	10,662	10,903	17,665
Net Interest	(115)	30	0	8	0
Tax	(1,871)	(3,498)	(2,334)	(5,141)	(6,186)
Capex	(2,426)	(1,346)	(471)	(1,434)	(1,550)
Financing / investments	(1,536)	1,301	79	(719)	0
Dividends	(1,671)	(5,221)	(2,611)	(9,075)	(4,869)
Net Cash Flow	3,467	3,441	5,325	(5,457)	5,060
Opening net (debt)/cash	6,703	10,170	13,611	18,936	13,479
Closing net (debt)/cash	10,170	13,611	18,936	13,479	18,539

Source: Edison Investment Research, company accounts

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