



## OTC Markets Group Inc. (OTCM)

**New Products And Client Growth, As Well As A Lower Tax Rate, Helped Fuel Strong Revenue In 1Q:17; Consistent Cash Flow Leads To Balanced Capital Approach; Maintain \$23 Price Target**

	2015		2016		2017E		2018E	
		OLD	NEW	OLD	NEW	OLD	NEW	
Mar.	\$0.16	\$0.20		\$0.20	\$0.26A	\$0.23	\$0.28	
June	0.20	0.21		0.22	0.24	0.24	0.26	
Sep.	0.26	0.26		0.26		0.27	0.26	
Dec.	<u>0.25</u>	<u>0.23</u>		<u>0.26</u>	<u>0.27</u>	<u>0.28</u>	<u>0.29</u>	
<b>EPS</b>	<b>\$0.88</b>	<b>\$0.90</b>		<b>\$0.94</b>	<b>\$1.03</b>	<b>\$1.02</b>	<b>\$1.08</b>	
<b>P/E</b>				<b>21.4x</b>		<b>20.4x</b>		

Note: NR = Not Rated. Risk Ratings: H = Highly risky; M = Moderately risky. 2015-2018E include a respective \$0.08, \$0.09, \$0.07 and \$0.07 in stock-based compensation expense. Sum of quarterly EPS may not equal full-year total due to rounding and/or change in share count. NC=Not covered by Sidoti & Co., LLC.

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017E	2018E
Rev.(Mil.)	\$24.1	\$28.0	\$30.8	\$33.2	\$33.6	\$39.8	\$47.5	\$48.6	\$50.0	\$52.3
GAAP EPS*	\$0.33	\$0.28	\$0.45	\$0.51	\$0.51	\$0.69	\$0.88	\$0.90	\$1.03	\$1.08

\* Revenue is net of redistribution fees.

**Description:** OTC Markets Group, Inc. (www.otcmkt.com) operates three lines of business centered on 10,000 U.S. and global securities clients. The company offers a cost-effective solution to penetrate the U.S. securities market, while providing a host of services that connect brokers and dealers, organize markets, and ultimately monetize OTC's vast database of information. OTC's three lines of business are Link ATS (24% of revenue), Market Data (41%) and Corporate Services (35%). Headquarters are in New York, NY.

- **OTCM reported 1Q:17 EPS of \$0.26 versus our expectation and the 1Q:16 result of EPS of \$0.20, with the increase driven by stronger revenue and operating leverage, as well as a lower tax rate, which accounted for about \$0.03 of EPS.**
- **Revenue of \$12.8 million increased 5% from the \$12.2 million recorded in 1Q:16 and was above our \$12.1 million forecast, with Corporate Services revenue up 14% and Market Data up 2%, somewhat offset by a 5% decline in Link revenue.**
- **The operating margin reached 33.2% in 1Q:17, compared with 31.2% in 1Q:16, and we think this highlights the operating leverage that revenue has over fixed costs for OTCM.**
- **We now expect EPS of \$1.03 (from \$0.94) in 2017, representing nearly 11% growth. We estimate 2018 EPS will increase 5% to \$1.08 (from \$1.02) on stronger revenue trends, operating leverage and a lower tax rate.**
- **OTCM exited 1Q:17 with cash of \$24 million (\$2.08 per share), and the board of directors issued a \$0.14 quarterly dividend (the 34th consecutive dividend) and announced a new 300,000 share repurchase plan.**
- **Our \$23 price target is based on about 22x to our revised 2018 EPS forecast of \$1.08 (from \$1.02).**

**OTCM reported 1Q:17 EPS of \$0.26.** Revenue of \$12.8 million increased 5% year over year and was above our \$12.1 million forecast. On a segment basis, revenue increased 14% in Corporate Services and 2% within Market Data sales, offset by a 5% decline in Link revenue. While results were in line with our forecasts for Link and Market Data, Corporate Services outpaced our estimates significantly, with the increase attributable to a combination of new clients, higher retention rates and price increases. The operating margin of 33.2% expanded 200 basis points, compared with 1Q:16, and was ahead of our 30% forecast. Operating costs of \$8.5 were up modestly, growing 2% year over year highlighting OTCM's ability to drive significant operating leverage inherent in its business model. Net income of

**NR**

Price Target: \$23

Price: \$22.00

Risk Rating: H

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### Key Statistics

Analysts Covering	2
Market Cap (Mil)	\$250
Enterprise Value	\$224
52-Week Range (US OTC)	25-16
5-Year EPS CAGR	12%
Avg. Daily Trading Volume	3,000
Shares Out (Mil)	11.265
Float Shares (Mil)	6.248
Insider Ownership	47%
Institutional Holdings	53%
Annualized Dividend	\$0.56
Dividend Yield	2.6%
FCF Per Share (2018E)	\$1.43
FCF Yield (2018E)	6.5%
Net Cash Per Share (2018E)	\$3.89
Price to Book Value	15.4x
Return on Equity (2018E)	38.8%
Total Debt to Capital	Nil
Interest Coverage Ratio	N/A
Short Interest %	N/A%
Short Interest Days To Cover	N/A
Russell 2000	1,389
Russell 2000 – Last 12 Months	23.0%
OTCM – Last 12 Months	27.4%



Source: FactSet Prices

\$3.1 million increased 35% from 1Q:16, leading to EPS of \$0.26, up 35% over the prior-year period, but note about \$0.03 of the increase was attributable to a lower tax rate of 28.3%, versus 38.9% in the prior-year period.

<b>Exhibit 1: OTCM 1Q:17 Review</b>					
\$ in millions except per share data					
	<u>1Q:16A</u>	<u>1Q:17A</u>	<u>YoY Change</u>	<u>1Q:17 E</u>	<u>Estimate Variance</u>
Revenue	\$12,158.0	\$12,752.0	4.9%	\$12,109.2	5.3%
Operating Income	\$3,797.0	\$4,238.0		\$3,637.9	
Operating Margin	31.2%	33.2%	6.4%	30.0%	10.6%
Net Income	\$2,252.0	\$3,050.0	35.4%	\$2,218.0	
Profit Margin	18.5%	23.9%		18.3%	30.6%
EPS	\$0.20	\$0.26	34.5%	\$0.20	32.4%

Sources: Company reports and Sidoti & Company, LLC. estimates.

**The 1Q:17 results indicate improving trends, in our view.** Strength in 1Q:17 was driven by several positive factors, in our view, ranging from stronger retention, non-professional user growth and new companies joining the OTCQX and OTCQB markets. OTCM reported a 93% retention rate for the OTCQX market, up from the prior year's 89% rate, resulting in larger annual subscription based revenue. While 2016 additions to the OTCQX and OTCQB markets were affected by market conditions leading to a lower rate of companies completing initial public offerings, 1Q:17 was a solid start with growth with 19 companies added in the OTCQX in 1Q:17( versus 13 a year ago), and 82 new companies added to the OTCQB (up from 56 a year ago). On the company's conference call, while an investment in the sales force was made and led to the improvement, the new Presidential administration and the possibility of looser regulations are also contributing factors. In addition, while a smaller piece of the growth in the period, non-professional user growth within the Market Data segment of the business increased 40% versus the prior year as OTCM continues to expand its distribution network with retail-based investors. Other highlights in the period include an additional state recognizing the OTCQX and OTCQB for Blue Sky exemption status, bringing the total of states to recognize either of the markets to 21. Management has commented that when the company reaches 30 states recognizing either the OTCQX or OTCQB for exemption status, it could be a positive tipping point for OTCM. We think that as OTCM gets more states to recognize the OTCQX and OTCQB markets for exemption status, this will help drive newer companies to OTCM because of the lower cost associated with these markets. Lastly, while we think Regulation A+ likely is still three to five years away from being a major revenue growth opportunity for OTCM, we think these exemptions will help substantially. Regulation A+ simplifies the process of seeking capital for companies looking to raise less than \$50 million of proceeds. While early in the adoption of this new path to market for smaller companies, Elio Motors (OTCQX: ELIO, NC) in February 2016 was first to list on the OTCQX Best Market, raising \$17 million through crowdfunding. We note that several crowdfunding platforms are forming. In our view, this should set the stage for more companies to use this pathway to raise capital.

**OTCM's commitment to a shareholder friendly capital allocation was evident in 1Q:17, in our view.** OTCM exited 1Q:17 with net cash of \$23 million (\$2.08 per share). We model free cash flow per share of \$1.37 in 2017 and \$1.43 in 2018, leading to cash of \$44 million (or \$3.89 per share) at the end of 2018. While the company's capital spending is relatively modest at less than \$1 million annually, cash flow historically was returned to shareholders in the form of a quarterly dividend, special dividends and share repurchases. In conjunction with the 1Q:17 earnings release, OTCM announced its 34th consecutive quarterly dividend, which is currently at \$0.14, and also announced a new 300,000 share repurchase program, of which 292,080 remain at the end of 1Q:17. This follows 2016 when OTCM returned \$14.7 million to shareholders in the form of dividends and share repurchase, up from the prior year's \$12.9 million in capital returned to holders. We note that while it is likely there will be more special dividends, we model only quarterly dividends into our forecast.

**We maintain a \$23 price target on OTCM shares.** This \$23 target is based on applying a multiple of 22x to our revised 2018 EPS forecast of \$1.08 (up from \$1.02). OTCM shares trade at 21x and 20x our respective 2017 and 2018 EPS forecasts. In the past five years, OTCM shares ranged from 12x-21x forward EPS and averaged 18x. Peers in the corporate service-based industry trade at 17x-26x (average 22x) estimated 2017 EPS and 16x-24x (average 20x) the consensus 2018 EPS forecast. Although OTCM's lack of liquidity validates the discount to the peers, we view the recurring-revenue model, profit profile, significant operating leverage, capital allocation and dividend payments as offsets. Meanwhile, as crowdfunding is relatively nascent in the capital markets world, we expect that as it matures the door will open for additional companies to use OTC's services.

<b>Key Risks</b>	Trading liquidity		
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OTC MARKETS GROUP INC.

Table 1. OTC Markets Group Inc., Income Statement

(\$ in thousands, except where noted)

	2015	Mar	June	Sept	Dec	2016	MarA	JuneE	SepE	DecE	2017E	Mar E	June E	Sep E	Dec E	2018E
OTC Link	\$11,796	\$2,754	\$2,658	\$2,530	\$2,631	\$10,573	\$2,618	\$2,525	\$2,505	\$2,605	\$10,252	\$2,644	\$2,550	\$2,530	\$2,631	\$10,355
Market Data	20,609	5,325	5,237	5,274	5,218	21,054	5,450	5,342	5,485	5,427	21,703	5,723	5,609	5,759	5,698	22,789
Corporate Services	17,504	4,672	4,744	4,809	5,029	19,254	5,308	4,934	5,001	5,230	20,473	5,626	5,230	5,301	5,544	21,702
<b>Total Revenue</b>	<b>\$49,909</b>	<b>\$12,751</b>	<b>\$12,639</b>	<b>\$12,613</b>	<b>\$12,878</b>	<b>\$50,881</b>	<b>\$13,376</b>	<b>\$12,801</b>	<b>\$12,991</b>	<b>\$13,262</b>	<b>\$52,429</b>	<b>\$13,993</b>	<b>\$13,389</b>	<b>\$13,590</b>	<b>\$13,873</b>	<b>\$54,845</b>
Redistribution fees	2,379	593	584	557	583	2,317	624	614	611	584	2,433	672	643	639	610	2,563
<b>Net Revenue</b>	<b>\$47,530</b>	<b>\$12,158</b>	<b>\$12,055</b>	<b>\$12,056</b>	<b>\$12,295</b>	<b>\$48,564</b>	<b>\$12,752</b>	<b>\$12,186</b>	<b>\$12,380</b>	<b>\$12,678</b>	<b>\$49,997</b>	<b>\$13,321</b>	<b>\$12,746</b>	<b>\$12,952</b>	<b>\$13,262</b>	<b>\$52,282</b>
Compensation	18,716	5,237	4,967	4,665	4,720	19,589	5,566	4,992	4,807	4,867	20,232	5,737	4,967	5,096	4,994	20,795
IT Infrastructure	4,860	1,340	1,375	1,378	1,376	5,469	1,404	1,395	1,403	1,392	5,595	1,427	1,406	1,359	1,387	5,579
Professional fees	1,811	499	438	439	356	1,732	350	448	455	371	1,624	392	469	476	416	1,752
Marketing & Advertising	1,291	280	184	175	210	849	243	256	260	212	971	224	268	272	277	1,041
Occupancy costs	1,484	405	367	442	412	1,626	395	384	390	398	1,567	420	402	408	416	1,645
D&A	1,692	417	410	387	392	1,606	395	384	390	398	1,567	420	402	408	416	1,645
General and administrative	810	183	195	171	217	766	161	128	130	225	644	238	268	272	277	1,055
<b>Total Operating Costs</b>	<b>\$30,664</b>	<b>\$8,361</b>	<b>\$7,936</b>	<b>\$7,657</b>	<b>\$7,683</b>	<b>\$31,637</b>	<b>\$8,514</b>	<b>\$7,988</b>	<b>\$7,834</b>	<b>\$7,864</b>	<b>\$32,199</b>	<b>\$8,858</b>	<b>\$8,181</b>	<b>\$8,290</b>	<b>\$8,185</b>	<b>\$33,513</b>
<b>Operating Income</b>	<b>\$16,866</b>	<b>\$3,797</b>	<b>\$4,119</b>	<b>\$4,399</b>	<b>\$4,612</b>	<b>\$16,927</b>	<b>\$4,238</b>	<b>\$4,199</b>	<b>\$4,547</b>	<b>\$4,814</b>	<b>\$17,797</b>	<b>\$4,464</b>	<b>\$4,566</b>	<b>\$4,662</b>	<b>\$5,077</b>	<b>\$18,768</b>
Other income (costs)	0	(8)	4	11	2	8	14	14	(2)	(2)	25	(2)	(2)	(2)	(2)	(7)
<b>Pretax Income</b>	<b>\$16,866</b>	<b>\$3,789</b>	<b>\$4,123</b>	<b>\$4,410</b>	<b>\$4,614</b>	<b>\$16,935</b>	<b>\$4,252</b>	<b>\$4,213</b>	<b>\$4,545</b>	<b>\$4,812</b>	<b>\$17,822</b>	<b>\$4,462</b>	<b>\$4,564</b>	<b>\$4,660</b>	<b>\$5,076</b>	<b>\$18,761</b>
Income Taxes	(6,635)	(1,474)	(1,608)	(1,404)	(1,921)	(6,407)	(1,202)	(1,474)	(1,591)	(1,684)	(5,952)	(1,294)	(1,597)	(1,631)	(1,777)	(6,299)
<b>Net Income</b>	<b>\$10,231</b>	<b>\$2,315</b>	<b>\$2,515</b>	<b>\$3,006</b>	<b>\$2,693</b>	<b>\$10,528</b>	<b>\$3,050</b>	<b>\$2,738</b>	<b>\$2,954</b>	<b>\$3,128</b>	<b>\$11,871</b>	<b>\$3,168</b>	<b>\$2,966</b>	<b>\$3,029</b>	<b>\$3,299</b>	<b>\$12,463</b>
Less restricted stock	(\$288)	(\$63)	(\$63)	(\$79)	\$0	(\$205)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
<b>Net Income To Common</b>	<b>\$9,943</b>	<b>\$2,252</b>	<b>\$2,452</b>	<b>\$2,927</b>	<b>\$2,693</b>	<b>\$10,323</b>	<b>\$3,050</b>	<b>\$2,738</b>	<b>\$2,954</b>	<b>\$3,128</b>	<b>\$11,871</b>	<b>\$3,168</b>	<b>\$2,966</b>	<b>\$3,029</b>	<b>\$3,299</b>	<b>\$12,463</b>
FD EPS	\$0.88	\$0.20	\$0.21	\$0.26	\$0.23	\$0.90	\$0.26	\$0.24	\$0.26	\$0.27	\$1.03	\$0.28	\$0.26	\$0.26	\$0.29	\$1.08
FD Shares Outstanding	11,289	11,440	11,431	11,429	11,371	11,340	11,520	11,520	11,520	11,520	11,520	11,510	11,510	11,510	11,510	11,510
Dividend	\$0.52	\$0.14	\$0.14	\$0.14	\$0.14	\$0.56	\$0.14	\$0.14	\$0.14	\$0.14	\$0.56	\$0.14	\$0.14	\$0.14	\$0.14	\$0.56
EBITDA	\$20,137	\$4,677	\$4,953	\$5,170	\$5,376	\$20,176	\$5,198	\$4,963	\$5,311	\$5,578	\$21,049	\$5,228	\$5,330	\$5,426	\$5,841	\$21,824
<b>Growth Analysis</b>																
Revenue YOY Growth	18.2%	10.6%	1.7%	(2.2%)	(1.4%)	1.9%	4.9%	1.3%	3.0%	3.0%	3.0%	4.6%	4.6%	4.6%	4.6%	4.6%
Adjusted Net Income YoY Growth	29.7%	24.7%	5.1%	(2.6%)	(8.0%)	2.9%	31.7%	8.9%	(1.7%)	16.2%	12.8%	3.9%	8.3%	2.5%	5.5%	5.0%
Adjusted FD EPS YoY Growth	27.9%	24.5%	5.2%	(3.1%)	(8.6%)	2.4%	30.8%	8.0%	(2.5%)	14.6%	11.0%	4.0%	8.4%	2.6%	5.6%	5.1%
<b>Margin Analysis</b>																
Operating Margin	35.5%	31.2%	34.2%	36.5%	37.5%	34.9%	33.2%	34.5%	36.7%	38.0%	35.6%	33.5%	35.8%	36.0%	38.3%	35.9%
EBITDA Margin	42.4%	38.5%	41.1%	42.9%	43.7%	41.5%	40.8%	40.7%	42.9%	44.0%	42.1%	39.2%	41.8%	41.9%	44.0%	41.7%
Adjusted Profit Margin	20.5%	18.2%	19.9%	23.8%	20.9%	20.7%	22.8%	21.4%	22.7%	23.6%	22.6%	22.6%	22.2%	22.3%	23.8%	22.7%
Tax Rate	39.3%	38.9%	39.0%	31.8%	39.0%	37.8%	28.3%	35.0%	35.0%	35.0%	33.4%	29.0%	35.0%	35.0%	35.0%	33.6%

Sources: Company reports, Sidoti & Company, LLC estimates

## Appendix Required Disclosures

### Required Disclosures

**OTC Markets Group Inc. (OTCM-\$22.00) NR Price Target: \$23 Risk Rating: H**

Rating and Price Target History Table

Action	Date	Px	Rating	PT	Risk Rating
Initiation	9/1/16	17	NR	21	H
PT	12/23/16	21.6		23	



<b>Key Risks</b>	Trading liquidity		
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#### Valuation:

**We maintain a \$23 price target on OTCM shares.** This \$23 target is based on applying a multiple of 22x to our revised 2018 EPS forecast of \$1.08 (up from \$1.02). OTCM shares trade at 21x and 20x our respective 2017 and 2018 EPS forecasts. In the past five years, OTCM shares ranged from 12x-21x forward EPS and averaged 18x. Peers in the corporate service-based industry trade at 17x-26x (average 22x) estimated 2017 EPS and 16x-24x (average 20x) the consensus 2018 EPS forecast. Although OTCM's lack of liquidity validates the discount to the peers, we view the recurring-revenue model, profit profile, significant operating leverage, capital allocation and dividend payments as offsets. Meanwhile, as crowdfunding is relatively nascent in the capital markets world, we expect that as it matures the door will open for additional companies to use OTC's services.

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## APPENDIX CONTINUED

subject to relatively high price volatility, are characterized by more stable and predictable cash flow, a more established operating history, and an operating environment that is somewhat less competitive with a potential for loss of principal. “*Highly Risky*” suggests high risk equities of companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, significant financial or legal issues, or a substantial risk/loss of principal. As of 05/05/17, Company Sponsored Research Cap Research provides research on 4 companies, of which 3 (75%) are rated Moderately Risky and 1 (25%) are rated Highly Risky. *Earnings* targets and opinions concerning the composition of market sectors included in this report reflect analyst judgments as of this date and are subject to change without notice. A risk to our *earnings* targets is that the analyst’s estimates or forecasts may not be met. This report contains forward-looking statements, which involve risks and uncertainties. Actual results may differ significantly from such forward-looking statements. Factors that may cause such differences include, but are not limited to, those discussed in the “Risk Factors” section in the issuer’s SEC filings available in electronic format through SEC Edgar filings at [www.sec.gov](http://www.sec.gov).

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