



OTC Markets Group Inc. (OTCM)

After Bounce Back In 2017, U.S. IPO Market Expected To Remain Solid In 2018; Do Not Yet Assume Any Benefit From Tax Cuts For OTCM Given Many “Moving Pieces”; Maintain \$30 Price Target

	2016	2017E		2018E		2019E	
		OLD	NEW	OLD	NEW	OLD	NEW
Mar.	\$0.20	\$0.26A		\$0.27		\$0.30	
June	0.21	0.26A		0.29		0.31	
Sep.	0.26	0.29A		0.29		0.31	
Dec.	<u>0.23</u>	<u>0.27</u>		<u>0.29</u>		<u>0.32</u>	
EPS	\$0.90	\$1.09		\$1.14		\$1.24	
P/E		27.2x		26.1x		24.0x	

Note: NR = Not Rated. Risk Ratings: H = Highly risky; M = Moderately risky. 2016-2019E 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	2010	2011	2012	2013	2014	2015	2016	2017E	2018E	2019E
Rev.(Mil.)	\$28.0	\$30.8	\$33.2	\$33.6	\$39.8	\$49.9	\$50.9	\$54.3	\$56.8	\$59.6
GAAP EPS	\$0.28	\$0.45	\$0.51	\$0.51	\$0.69	\$0.88	\$0.90	\$1.09	\$1.14	\$1.24

* 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.

- **In 2017, the U.S. IPO market consisted of 189 offerings, compared with 111 in 2016. Initial 2018 expectations for IPOs in the U.S. are similar to the 2017 tally.**
- **We think the improving economy and possible looser regulatory measures could help strengthen the IPO market; this would enhance revenue and EPS prospects for OTCM, in our view.**
- **We do not yet assume a benefit for OTCM related to the change in the U.S. corporate tax rate to 21%, from 35%; at most, we think there could be a 10% lift to EPS in 2018 and 2019. (See Exhibit 1.)**
- **We view OTCM as well positioned for growth through a combination of enhanced services and expanded offerings in an improving market backdrop, and model annual EPS growth of 21% in 2017, 5% in 2018 and 9% in 2019.**
- **OTCM exited 3Q:17 with cash of \$25 million (\$2.12 per share) and no debt; the board of directors issued a third consecutive \$0.60 per share special dividend, as well as the regular \$0.14 per share quarterly dividend, in 4Q:17.**
- **Our \$30 price target is based on 24x our 2019 EPS forecast of \$1.24.**

Expectations are that the improvement in the IPO market in 2017 will continue in 2018.

In 2017, there were 189 successful IPOs in the U.S., compared with 111 in 2016. The surge in 2017 IPOs was credited to stronger economic data and the rise in the stock markets. Ernst & Young's recently published outlook for the U.S. IPO market calls for more of the same in 2018, while also suggesting a modest improvement if current trends related to the stock market and economic data in the U.S. continue. Additionally, an ease in the regulatory environment through the Improving Access to Capital Act could also benefit the IPO market, but this act only recently passed the House of Representatives. In 2017, the IPO markets in the U.S. helped drive solid top-line trends for OTCM throughout the year. OTCM also benefited from newer service offerings and pricing structures that drove revenue growth. Regarding the annual tax rate, OTCM lowered its tax rate to about 31%, from 38% reported

NR

Price Target: \$30

Price: \$29.70

Risk Rating: H

Christopher McGinnis

(212) 894-3353

(cmcginnis@sidoti.com)

Key Statistics

Analysts Covering	2
Market Cap (Mil)	\$330
Enterprise Value	\$320
52-Week Range (US OTC)	32-19
5-Year EPS CAGR	12%
Avg. Daily Trading Volume	3,000
Shares Out (Mil)	11.265
Float Shares (Mil)	N/A
Insider Ownership	47%
Institutional Holdings	53%
Annualized Dividend	\$0.56
Dividend Yield	1.9%
FCF Per Share (2019E)	\$1.43
FCF Yield (2019E)	4.8%
Net Cash Per Share (2019E)	\$4.34
Price to Book Value	17.6x
Return on Equity (2019E)	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	1,553
Russell 2000 – Last 12 Months	14.2%
OTCM – Last 12 Months	29.1%



OTC Markets Group Inc.

Source: FactSet/Prices

in 2016. In Exhibit 1, we highlight 21%, 26% and 38% tax rates and estimated EPS under each scenario. For now, we project about a 33% annual tax rate in both 2018 and 2019. In our view, due to a number of puts and takes, we think OTCM's tax rate could fall near 26%, which would benefit our EPS estimate by about 10% in both 2018 and 2019, compared with our current forecasts. We expect more details on the tax benefit on OTCM's next earnings call slated for late February or early March.

Exhibit 1. OTC Markets Group Inc. Tax Analysis							
		2018 Tax Rate			2019 Tax Rate		
		21%	26%	38%			
2018 EPS	\$1.33	\$1.25	\$1.05		2019 EPS	\$1.46	\$1.37

Sources: Sidoti & Company LLC estimates

OTCM is well positioned for solid growth through 2019, by our forecast. OTCM offers a more efficient option in the financial markets, with services that revolve around greater transparency, more organized markets and improved information at a cost effective subscription-based model. Expanded services and markets led to a 9% revenue CAGR in the last six years and an EPS CAGR of 16%. On the regulatory front, the OTCQX and OTCQB markets are now recognized for Blue Sky exemption status in 27 states. The exemption status will drive more smaller companies to use OTCM's services, which offer a simplified and cost efficient pathway to market. Lastly, Regulation A+ simplifies the process of seeking capital for companies looking to raise less than \$50 million of proceeds through crowdfunding. While early in the adoption of this new path to market for smaller companies, there were several successful transactions; we expect the rate of adoption of Regulation A+ to increase over time. While we think Regulation A+ is still three to five years away from being a major revenue growth opportunity for OTCM, we see positive data points about adoption of this funding pathway. Given all this, we estimate revenue growth of about 7% in 2017 and 5% annually in 2018 and 2019 and EPS growth of 21% in 2017, 5% in 2018 and 9% in 2019

OTCM has a strong balance sheet and a shareholder friendly capital allocation plan, in our view. OTCM exited 3Q:17 with cash of \$25 million (\$2.12 per share) and no debt. We model free cash flow per share of \$1.30 in 2017, \$1.38 in 2018 and \$1.43 in 2019, leading to cash of \$50 million (or \$4.34 per share) at the end of 2019. 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 4Q:17, OTCM announced a \$0.60 per share special dividend, the third-consecutive year of such a special dividend. Additionally, the company pays a \$0.14 per share quarterly dividend. On the share repurchase front, OTCM repurchased 99,302 shares through 3Q:17, at an average price of \$21.91 each. In 2016, OTCM returned \$14.7 million to shareholders in the form of dividends and share repurchases, up from \$12.9 million in 2015. We note that while it is likely there will be more special dividends, we model only quarterly dividends in our forecast.

We maintain a \$30 target on OTCM shares. This target is based on 24x our 2019 EPS forecast of \$1.24. OTCM shares trade at 26x and 24x our respective 2018 and 2019 EPS forecasts. In the past three years, OTCM shares ranged from 16x-28x forward estimated EPS and averaged 22x. Peers in the corporate service-based industry trade at 19x-28x (average 24x) estimated 2018 EPS forecasts. 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 more companies to use OTC's services.

Key Risks	Trading liquidity		

OTC MARKETS GROUP INC.

Table 1. OTC Markets Group Inc., Income Statement

(\$ in thousands, except where noted)

	Mar	June	Sept	Dec	2016	MarA	JuneA	SepA	DecE	2017E	Mar	June	Sep	Dec	2018E	2019E
OTC Link	\$2,754	\$2,658	\$2,530	\$2,631	\$10,573	\$2,618	\$2,497	\$2,413	\$2,499	\$10,027	\$2,618	\$2,497	\$2,413	\$2,499	\$10,027	\$10,027
Market Data	5,325	5,237	5,274	5,218	21,054	5,450	5,522	5,505	5,427	21,904	5,723	5,798	5,780	5,698	22,999	24,379
Corporate Services	4,672	4,744	4,809	5,029	19,254	5,308	5,750	5,704	5,632	22,394	5,626	6,095	6,046	5,970	23,738	25,162
Total Revenue	\$12,751	\$12,639	\$12,613	\$12,878	\$50,881	\$13,376	\$13,769	\$13,622	\$13,559	\$54,326	\$13,967	\$14,390	\$14,239	\$14,168	\$56,765	\$59,569
Redistribution fees	593	584	557	583	2,317	624	626	584	597	2,431	670	691	669	623	2,654	2,785
Net Revenue	\$12,158	\$12,055	\$12,056	\$12,295	\$48,564	\$12,752	\$13,143	\$13,038	\$12,962	\$51,895	\$13,297	\$13,699	\$13,570	\$13,545	\$54,111	\$56,784
Compensation	5,237	4,967	4,665	4,720	19,589	5,566	5,243	5,250	5,220	21,279	5,726	5,483	5,411	5,384	22,004	22,942
IT Infrastructure	1,340	1,375	1,378	1,376	5,469	1,404	1,426	1,499	1,491	5,820	1,425	1,511	1,424	1,417	5,776	6,062
Professional fees	499	438	439	356	1,732	350	399	560	380	1,689	391	417	427	425	1,661	1,549
Marketing & Advertising	280	184	175	210	849	243	227	190	217	877	223	230	228	283	965	1,013
Occupancy costs	405	367	442	412	1,626	395	451	469	407	1,722	419	432	427	425	1,703	1,787
D&A	417	410	387	392	1,606	395	399	300	407	1,501	419	432	427	425	1,703	1,191
General and administrative	183	195	171	217	766	161	174	180	230	745	237	187	142	283	850	892
Total Operating Costs	\$8,361	\$7,936	\$7,657	\$7,683	\$31,637	\$8,514	\$8,319	\$8,448	\$8,352	\$33,633	\$8,841	\$8,692	\$8,487	\$8,642	\$34,662	\$35,436
Operating Income	\$3,797	\$4,119	\$4,399	\$4,612	\$16,927	\$4,238	\$4,824	\$4,590	\$4,610	\$18,262	\$4,455	\$5,008	\$5,083	\$4,902	\$19,449	\$21,348
Other income (costs)	(8)	4	11	2	8	14	22	5	10	51	10	10	10	10	40	40
Pretax Income	\$3,789	\$4,123	\$4,410	\$4,614	\$16,935	\$4,252	\$4,846	\$4,595	\$4,620	\$18,313	\$4,465	\$5,018	\$5,093	\$4,912	\$19,489	\$21,388
Income Taxes	(1,474)	(1,608)	(1,404)	(1,921)	(6,407)	(1,230)	(1,800)	(1,200)	(1,525)	(5,755)	(1,295)	(1,706)	(1,732)	(1,621)	(6,354)	(7,028)
Net Income	\$2,315	\$2,515	\$3,006	\$2,693	\$10,528	\$3,022	\$3,046	\$3,395	\$3,095	\$12,558	\$3,170	\$3,312	\$3,362	\$3,291	\$13,135	\$14,360
Less restricted stock	(\$63)	(\$63)	(\$79)	\$0	(\$205)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Net Income To Common	\$2,252	\$2,452	\$2,927	\$2,693	\$10,323	\$3,022	\$3,046	\$3,395	\$3,095	\$12,558	\$3,170	\$3,312	\$3,362	\$3,291	\$13,135	\$14,360
FD EPS	\$0.20	\$0.21	\$0.26	\$0.23	\$0.90	\$0.26	\$0.26	\$0.29	\$0.27	\$1.09	\$0.27	\$0.29	\$0.29	\$0.29	\$1.14	\$1.24
FD Shares Outstanding	11,440	11,431	11,429	11,371	11,340	11,520	11,520	11,594	11,594	11,557	11,548	11,548	11,548	11,548	11,548	11,548
Dividend	\$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	\$0.56
EBITDA	\$4,677	\$4,953	\$5,170	\$5,376	\$20,176	\$5,198	\$5,861	\$5,342	\$5,362	\$21,763	\$5,207	\$5,760	\$5,835	\$5,654	\$22,457	\$24,356
Growth Analysis																
Revenue YOY Growth	10.6%	1.7%	(2.2%)	(1.4%)	1.9%	4.9%	8.9%	8.0%	5.3%	6.8%	4.4%	4.5%	4.5%	4.5%	4.5%	4.9%
Adjusted Net Income YoY Growth	24.7%	5.1%	(2.6%)	(8.0%)	2.9%	34.2%	24.2%	16.0%	14.9%	21.7%	4.9%	8.7%	(1.0%)	6.3%	4.6%	9.3%
Adjusted FD EPS YoY Growth	24.5%	5.2%	(3.1%)	(8.6%)	2.4%	33.3%	23.3%	14.3%	16.1%	20.7%	4.7%	8.5%	(0.6%)	6.7%	4.7%	9.3%
Margin Analysis																
Operating Margin	31.2%	34.2%	36.5%	37.5%	34.9%	33.2%	36.7%	35.2%	35.6%	35.2%	33.5%	36.6%	37.5%	36.2%	35.9%	37.6%
EBITDA Margin	38.5%	41.1%	42.9%	43.7%	41.5%	40.8%	44.6%	41.0%	41.4%	41.9%	39.2%	42.0%	43.0%	41.7%	41.5%	42.9%
Adjusted Profit Margin	18.2%	19.9%	23.8%	20.9%	20.7%	22.6%	22.1%	24.9%	22.8%	23.1%	22.7%	23.0%	23.6%	23.2%	23.1%	24.1%
Tax Rate	38.9%	39.0%	31.8%	41.6%	37.8%	28.9%	37.1%	26.1%	33.0%	31.4%	29.0%	34.0%	34.0%	33.0%	32.6%	32.9%

Sources: Company reports, Sidoti & Company, LLC estimates

Appendix
Required Disclosures

Required Disclosures

OTC Markets Group Inc. (OTCM-\$29.70) NR Price Target: \$30 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	
PT	8/10/17	25.2		27	
PT	9/29/17	29.8		30	



Key Risks	Trading liquidity		
------------------	-------------------	--	--

Valuation:

We maintain a \$30 target on OTCM shares. This target is based on 24x our 2019 EPS forecast of \$1.24. OTCM shares trade at 26x and 24x our respective 2018 and 2019 EPS forecasts. In the past three years, OTCM shares ranged from 16x-28x forward estimated EPS and averaged 22x. Peers in the corporate service-based industry trade at 19x-28x (average 24x) estimated 2018 EPS forecasts. 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 more companies to use OTC's services.

Sidoti & Company. Sidoti & Company, LLC is a licensed broker/dealer, and publishes research reports about some of the securities it follows. All research published by Sidoti & Company, LLC is based on public information, or on information from the company discussed in the report that that company is required to promptly make public. This report was prepared for market professionals and institutional investor customers. Market professionals and institutional investors should consider this report as only one factor in making their investment decisions. This report is for information purposes only and is not intended as an offer to sell or a solicitation to buy securities. This research report is not a substitute for the exercise of your independent judgment. Information contained herein is based on sources we believe to be reliable but we do not guarantee their accuracy. The stock rating on this report reflects the analyst's recommendation based on a 12-month period. It should be presumed that the analyst who authored this report has had discussions with the subject company to ensure factual accuracy prior to publication.

Sidoti does NOT own securities of the issuers described herein, and Sidoti does not make a market in any securities. Sidoti does not engage in, or receive compensation from, any investment banking or corporate finance-related activities with the company discussed in the report. Sidoti's contracts with issuers protect Sidoti's full editorial control of all research, timing of release of reports, and release from liability for negative reports. To ensure further independence, the company discussed in the report has agreed to a minimum coverage term of one Initiation Report and three Update Reports, which that company cannot unilaterally terminate earlier. Sidoti & Company, LLC takes steps to ensure analyst independence including setting fees in advance and utilizing analysts who must abide by the CFA Institute Code of Ethics and Standards of Professional Conduct. Each Sidoti & Company, LLC analyst has full discretion on the rating and revenue target based on his or her own due diligence. Analysts are paid in part based on overall profitability of Sidoti & Company, LLC. Such profitability is derived from a variety of sources and includes payments received from issuers of securities covered by Sidoti & Company, LLC for services described below. No part of analyst compensation was, or will be, directly or indirectly, related to the specific recommendations or views expressed in any report or article. All issuers to be considered for research obtain the approval of a stock selection committee comprised of the Director of Research, the Chief Compliance Officer, and an independent outside person for screening applicants.

Sidoti Company Sponsored Research Rating System The Sidoti & Company, LLC *Company Sponsored Research* rating

APPENDIX CONTINUED

system consists of “Moderately Risky” (M) and “Highly Risky” (H) ratings. “Moderately Risky” suggests companies, that while still 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 01/04/18, Company Sponsored Research Cap Research provides research on 7 companies, of which 4 (57%) are rated Moderately Risky and 3 (42%) 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.

Every company in the Microcap sector bears certain inherent risks and Sidoti & Company, LLC will not provide any company subject to those risks with a rating below moderate because stock in the Microcap segment of the market have many risks that are not as prevalent in Large-Cap, Blue Chips, or even Small-Cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the Microcap segment of the market.

Compensation. Sidoti & Company, LLC received a flat fee of \$40,000, renewable annually from the company discussed in this report for the creation and dissemination of an Initiation Report and three Update Reports, including this report. The purpose of the fee is to subsidize the high costs of research and monitoring. Sidoti holds a conference twice a year and charges a fee of \$5,000 per conference for presenting companies. Sidoti does not currently have a current investment banking services relationship with the company discussed in this report, or contemporaneously with any other companies discussed in other (Sidoti) *Company Sponsored Research* reports. Sidoti has not received investment banking income from the company discussed in the report in the past 12 months, and does not expect to receive investment banking income from the company discussed in the report in the next 12 months. Of securities rated in other Sidoti Company Sponsored Research reports, Sidoti has received investment banking income from 0 companies (0%) in the past 12 months. Investment banking services, as defined under FINRA Rule 2241, include, among other things, acting as an underwriter in, or as a member of the selling group in, a securities underwriting. Sidoti’s role in any issuer’s investment banking transaction can be viewed in that issuer’s filings at www.sec.gov.

Sidoti has non-research employees who will seek compensation for brokerage commission revenue in connection with market trading the securities of this company. Sidoti & Company, LLC has received compensation for non-investment banking services on the Small-Cap Universe, and expects to receive additional compensation for non-investment banking services on the Small-Cap Universe, paid by issuers of securities covered by Sidoti & Company, LLC analysts. These non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, investment research, investment management, non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Sidoti & Company, LLC.

Sidoti Analysts. The research analyst certifies that this report accurately reflects his/her personal views about the subject securities and issuers and that none of the research analyst’s compensation was, is or will be, directly or indirectly, related to the analyst’s specific recommendations or views contained in this research report. Sidoti policy does not allow an analyst or a member of their household (i) to own, trade, or have any beneficial interest in any securities of any company that analyst covers, or (ii) serve as an officer or director of a covered company. Sidoti employees, including research analysts, receive compensation that is based in part upon the overall performance of the firm, including revenues generated by Sidoti’s investment banking and brokerage activities, but compensation is not directly related to investment banking or brokerage revenues.

Sidoti maintains and enforces written policies and procedures reasonably designed to prevent any controlling persons, officers (or persons performing similar functions), or employees of Sidoti from influencing the activities of research analysts and the content of research reports prepared by the research analyst. Sidoti research analysts seek to have management of their covered companies meet with investors during non-deal road shows. Analysts’ compensation may be related to their success in scheduling non-deal road shows. This approach could be viewed as presenting potential conflicts of interest.

Reprints of Sidoti & Company, LLC reports are prohibited without permission. Additional information is available upon request. For any further questions, please contact the Chief Compliance Officer at Sidoti.

Source

Key Statistics data is sourced from FactSet Research Systems