



## OTC Markets Group Inc. (OTCM)

**Raise Target To \$30 (From \$27) As We Introduce Our Initial 2019 Forecasts; View OTCM As Well Positioned To Drive Growth With Positive Economic And Regulatory Backdrops**

	2016	2017E		2018E		2019E	
		OLD	NEW	OLD	NEW	OLD	NEW
Mar.	\$0.20	\$0.26A		\$0.28			\$0.30
June	0.21	0.26A		0.28			0.31
Sep.	0.26	0.27		0.29			0.31
Dec.	<u>0.23</u>	<u>0.27</u>		<u>0.29</u>			<u>0.32</u>
EPS	<b>\$0.90</b>	<b>\$1.06</b>		<b>\$1.14</b>			<b>\$1.24</b>
P/E		<b>28.0x</b>		<b>26.1x</b>			<b>24.0x</b>

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	\$53.7	\$56.2	\$59.0
GAAP EPS	\$0.28	\$0.45	\$0.51	\$0.51	\$0.69	\$0.88	\$0.90	\$1.06	\$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 our view, OTCM is well positioned to deliver both top- and bottom-line growth, through a more efficient offering in the financial markets, given positive backdrops on both the economic and regulatory fronts.
- The Improving Access to Capital Act, recently passed by the House of Representatives, would expand Regulation A+ to SEC reporting companies, which we view as a long-term positive opportunity for OTCM.
- We estimate EPS growth of 15% on revenue growth of 6% in 2017, and EPS growth of 7% in 2018 and 9% in 2019 on annual revenue growth of 5%.
- OTCM exited 2Q:17 with cash of \$23 million (\$1.96 per share). We model FCF per share of \$1.38 in 2017, \$1.42 in 2018 and \$1.52 in 2019; we think FCF will be used to support growth initiatives, dividends and share repurchases.
- Our new \$30 price target is based on 24x our newly introduced 2019 EPS forecast of \$1.24. (Previously, we valued the shares at 24x our 2018 EPS forecast of \$1.14 to derive a \$27 target.)

**We estimate OTCM will post solid growth through 2019.** OTCM offers a more efficient option within 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 drove a 9% revenue CAGR in the last six years; with a scalable business, EPS expanded at a 16% CAGR in the same period. We think there are a number of factors that position OTCM well to continue to post top- and bottom-line growth. In 2Q:17, Form 211 filings of 109 were the most in the last six quarters, indicating to us a likely rise in IPOs, a key revenue driver for OTCM. On the regulatory front, the OTCQX and OTCQB markets are now recognized for Blue Sky exemption status in 25 states. This exemption will drive more companies to use OTCM's services, which offer a simplified and cost efficient pathway to market for smaller firms. Lastly, Regulation A+ simplifies the process of seeking capital for companies looking to raise less than \$50 million

**NR**

Price Target: \$30

Price: \$29.80

Risk Rating: H

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### Key Statistics

Analysts Covering	2
Market Cap (Mil)	\$340
Enterprise Value	\$322
52-Week Range (US OTC)	32-17
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	1.9%
FCF Per Share (2019E)	\$1.52
FCF Yield (2019E)	5.1%
Net Cash Per Share (2019E)	\$4.64
Price to Book Value	19.6x
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	1,489
Russell 2000 – Last 12 Months	19.8%
OTCM – Last 12 Months	75.4%



of proceeds through crowdfunding. While we think Regulation A+ likely is still three to five years away from being a major revenue growth opportunity for OTCM, we see positive data points about greater rates of adoption of this funding pathway, including several successful transactions. Additionally, on the legislative front, the Improving Access to Capital Bill was recently passed by the House of Representatives; this bill would allow SEC-reporting companies to use this option to raise capital. These positive points support our forecast for revenue growth of 6% in 2017 and 5% annually in 2018 and 2019 and EPS growth of 17% in 2017, 7% in 2018 and 9% in 2019.

**OTCM has a strong balance sheet and a shareholder friendly capital allocation plan, in our view.** OTCM exited 2Q:17 with net cash of \$23 million (\$2.08 per share). We model free cash flow per share of \$1.38 in 2017, \$1.42 in 2018 and \$1.52 in 2019, leading to cash of \$53 million (or \$4.64 per share) at the end of 2019. While 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. OTCM recently paid its 35th consecutive quarterly dividend, which is currently \$0.14 per share. We note that in 2015 and 2016 OTCM paid a special dividend of \$0.60 per share. Additionally through 2Q:17, OTCM repurchased 80,034 shares for an average price of \$21.14 per. In 2016, OTCM returned \$14.7 million to shareholders in the form of dividends and share repurchases, up from \$12.9 million in 2015. While it is likely there will be more special dividends, we model only regular dividends into our forecast.

**We raise our price target to \$30 (from \$27) on OTCM shares.** This new target is based on 24x our newly introduced 2019 EPS forecast of \$1.24. (Previously, we valued the shares at 24x our 2018 EPS forecast of \$1.14.) 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 EPS and averaged 21x. Peers in the corporate service-based industry trade at 19x-28x (average 23x) estimated 2017 EPS and 18x-26x (average 21x) 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 more companies will 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)

	Mar	June	Sept	Dec	2016	MarA	JuneA	SepE	DecE	2017E	Mar	June	Sep	Dec	2018E	2019E
OTC Link	\$2,754	\$2,658	\$2,530	\$2,631	\$10,573	\$2,618	\$2,497	\$2,404	\$2,499	\$10,018	\$2,644	\$2,522	\$2,428	\$2,524	\$10,118	\$10,219
Market Data	5,325	5,237	5,274	5,218	21,054	5,450	5,522	5,485	5,427	21,884	5,723	5,798	5,759	5,698	22,978	24,357
Corporate Services	4,672	4,744	4,809	5,029	19,254	5,308	5,750	5,242	5,482	21,781	5,626	6,095	5,556	5,811	23,088	24,474
<b>Total Revenue</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>\$13,769</b>	<b>\$13,130</b>	<b>\$13,408</b>	<b>\$53,683</b>	<b>\$13,993</b>	<b>\$14,415</b>	<b>\$13,743</b>	<b>\$14,033</b>	<b>\$56,184</b>	<b>\$59,049</b>
Redistribution fees	593	584	557	583	2,317	624	626	617	590	2,457	672	692	646	617	2,627	2,761
<b>Net Revenue</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>\$13,143</b>	<b>\$12,513</b>	<b>\$12,818</b>	<b>\$51,226</b>	<b>\$13,321</b>	<b>\$13,723</b>	<b>\$13,097</b>	<b>\$13,416</b>	<b>\$53,557</b>	<b>\$56,289</b>
Compensation	5,237	4,967	4,665	4,720	19,589	5,566	5,243	4,858	4,934	20,601	5,737	5,492	5,085	5,052	21,366	22,456
IT Infrastructure	1,340	1,375	1,378	1,376	5,469	1,404	1,426	1,418	1,435	5,683	1,427	1,514	1,374	1,403	5,718	6,010
Professional fees	499	438	439	356	1,732	350	399	394	375	1,518	392	418	412	421	1,643	1,535
Marketing & Advertising	280	184	175	210	849	243	227	210	215	895	224	231	220	281	955	1,004
Occupancy costs	405	367	442	412	1,626	395	451	394	402	1,642	420	432	412	421	1,686	1,771
D&A	417	410	387	392	1,606	395	399	394	402	1,590	420	432	412	421	1,686	1,181
General and administrative	183	195	171	217	766	161	174	131	228	694	238	187	137	281	843	886
<b>Total Operating Costs</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>\$8,319</b>	<b>\$7,799</b>	<b>\$7,991</b>	<b>\$32,623</b>	<b>\$8,858</b>	<b>\$8,707</b>	<b>\$8,053</b>	<b>\$8,279</b>	<b>\$33,897</b>	<b>\$34,843</b>
<b>Operating Income</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>\$4,824</b>	<b>\$4,714</b>	<b>\$4,827</b>	<b>\$18,603</b>	<b>\$4,464</b>	<b>\$5,016</b>	<b>\$5,044</b>	<b>\$5,136</b>	<b>\$19,660</b>	<b>\$21,446</b>
Other income (costs)	(8)	4	11	2	8	14	22	10	10	56	10	10	10	10	40	40
<b>Pretax Income</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>\$4,846</b>	<b>\$4,724</b>	<b>\$4,837</b>	<b>\$18,659</b>	<b>\$4,474</b>	<b>\$5,026</b>	<b>\$5,054</b>	<b>\$5,146</b>	<b>\$19,700</b>	<b>\$21,486</b>
Income Taxes	(1,474)	(1,608)	(1,404)	(1,921)	(6,407)	(1,230)	(1,800)	(1,650)	(1,730)	(6,410)	(1,297)	(1,759)	(1,769)	(1,801)	(6,627)	(7,227)
<b>Net Income</b>	<b>\$2,315</b>	<b>\$2,515</b>	<b>\$3,006</b>	<b>\$2,693</b>	<b>\$10,528</b>	<b>\$3,022</b>	<b>\$3,046</b>	<b>\$3,074</b>	<b>\$3,107</b>	<b>\$12,249</b>	<b>\$3,176</b>	<b>\$3,267</b>	<b>\$3,285</b>	<b>\$3,345</b>	<b>\$13,073</b>	<b>\$14,259</b>
Less restricted stock	(\$63)	(\$63)	(\$79)	\$0	(\$205)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
<b>Net Income To Common</b>	<b>\$2,252</b>	<b>\$2,452</b>	<b>\$2,927</b>	<b>\$2,693</b>	<b>\$10,323</b>	<b>\$3,022</b>	<b>\$3,046</b>	<b>\$3,074</b>	<b>\$3,107</b>	<b>\$12,249</b>	<b>\$3,176</b>	<b>\$3,267</b>	<b>\$3,285</b>	<b>\$3,345</b>	<b>\$13,073</b>	<b>\$14,259</b>
FD EPS	\$0.20	\$0.21	\$0.26	\$0.23	\$0.90	\$0.26	\$0.26	\$0.27	\$0.27	\$1.06	\$0.28	\$0.28	\$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	11,520	11,520	11,520	11,511	11,511	11,511	11,511	11,511	11,511
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	\$5,751	\$5,864	\$22,674	\$5,501	\$6,053	\$6,081	\$6,173	\$23,808	\$25,594
<b>Growth Analysis</b>																
Revenue YOY Growth	10.6%	1.7%	(2.2%)	(1.4%)	1.9%	4.9%	8.9%	4.1%	4.1%	5.5%	4.6%	4.7%	4.7%	4.7%	4.7%	5.1%
Adjusted Net Income YoY Growth	24.7%	5.1%	(2.6%)	(8.0%)	2.9%	30.5%	21.1%	2.3%	15.4%	16.3%	5.1%	7.3%	6.9%	7.7%	6.7%	9.1%
Adjusted FD EPS YoY Growth	24.5%	5.2%	(3.1%)	(8.6%)	2.4%	29.6%	23.3%	4.2%	17.3%	14.5%	5.2%	7.3%	7.0%	7.8%	6.8%	9.1%
<b>Margin Analysis</b>																
Operating Margin	31.2%	34.2%	36.5%	37.5%	34.9%	33.2%	36.7%	37.7%	37.7%	36.3%	33.5%	36.6%	38.5%	38.3%	36.7%	38.1%
EBITDA Margin	38.5%	41.1%	42.9%	43.7%	41.5%	40.8%	44.6%	46.0%	45.7%	44.3%	41.3%	44.1%	46.4%	46.0%	44.5%	45.5%
Adjusted Profit Margin	18.2%	19.9%	23.8%	20.9%	20.7%	22.6%	22.1%	23.4%	23.2%	22.8%	22.7%	22.7%	23.9%	23.8%	23.3%	24.1%
Tax Rate	38.9%	39.0%	31.8%	41.6%	37.8%	28.9%	37.1%	35.0%	35.0%	34.4%	29.0%	35.0%	35.0%	35.0%	33.6%	33.6%

Sources: Company reports, Sidoti & Company, LLC estimates

## Appendix

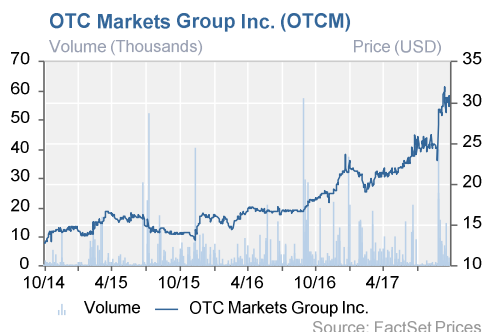
### Required Disclosures

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**OTC Markets Group Inc. (OTCM-\$29.80) 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	



#### Key Risks

Trading liquidity

#### Valuation:

**We raise our price target to \$30 (from \$27) on OTCM shares.** This new target is based on 24x our newly introduced 2019 EPS forecast of \$1.24. (Previously, we valued the shares at 24x our 2018 EPS forecast of \$1.14.) 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 EPS and averaged 21x. Peers in the corporate service-based industry trade at 19x-28x (average 23x) estimated 2017 EPS and 18x-26x (average 21x) 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 more companies will use OTC's services.

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## APPENDIX CONTINUED

**Sidoti Company Sponsored Research Rating System** The Sidoti & Company, LLC *Company Sponsored Research* rating 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 09/29/17, Company Sponsored Research Cap Research provides research on 6 companies, of which 5 (83%) are rated Moderately Risky and 1 (16%) 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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