



## OTC Markets Group Inc. (OTCM)

**Stronger Revenue Trends And Lower Tax Rate Fuel 3Q:17 EPS Beat; OTCM Announces Third \$0.60 Per Share Special Dividend; View OTCM As Well Positioned For Growth; Maintain \$30 Price Target**

	2016	2017E		2018E		2019E	
		OLD	NEW	OLD	NEW	OLD	NEW
Mar.	\$0.20	\$0.26A		\$0.28	\$0.27	\$0.30	
June	0.21	0.26A		0.28	0.29	0.31	
Sep.	0.26	0.27	0.29A	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>\$1.09</b>	<b>\$1.14</b>		<b>\$1.24</b>	
P/E			<b>24.6x</b>	<b>23.5x</b>		<b>21.6x</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	\$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.

- **OTCM reported 3Q:17 EPS of \$0.29, versus our expectation of \$0.27 and 3Q:16 EPS of \$0.26, with the increase driven by stronger revenue, modestly offset by higher operating costs to drive growth.**
- **Revenue of \$13.6 million rose 8% from \$12.6 million in 3Q:16 and was above our \$13.1 million forecast, with Corporate Services revenue up 19% and Market Data up 4%, somewhat offset by a 5% decline in Link revenue.**
- **The operating margin of 33.7% in 3Q:17 fell 120 basis points from 34.9% in 3Q:16, below our 35.9% forecast, with the higher costs coming from compensation and IT investments to drive growth opportunities.**
- **We continue to view OTCM as well positioned for growth through a combination of enhanced services and expanded offerings in an improving market backdrop, and model year-over-year 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); in addition, the board of directors issued a \$0.14 quarterly dividend, while also announcing a third-consecutive annual special dividend of \$0.60 payable in 4Q:17.**
- **Our \$30 price target is based on 24x our 2019 EPS forecast of \$1.24.**

**OTCM reported 3Q:17 EPS of \$0.29.** Revenue of \$13.6 million increased 8% year over year and was above our \$13.1 million forecast. On a segment basis, revenue rose 19% in Corporate Services and 4% in Market Data sales, offset by a 5% decline in LINK revenue. Strength in Corporate services was driven by a combination of new companies on the OTCQB and OTCQX and increased pricing in 2017 versus 2016. Market Data revenue growth of 4% increased largely due to the rise in non-professional user licenses and greater use of compliance analytics data. We attribute the decline in LINK revenue to a drop in overall market participants. The operating margin of 33.7% contracted 120 basis points, compared with 3Q:16, and was below of our 35.9% forecast. While we view OTCM as having the ability to drive operating leverage, we view the increase in compensation and IT

**NR**

Price Target: \$30

Price: \$26.80

Risk Rating: H

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### Key Statistics

Analysts Covering	2
Market Cap (Mil)	\$300
Enterprise Value	\$286
52-Week Range (US OTC)	32-17
5-Year EPS CAGR	12%
Avg. Daily Trading Volume	4,000
Shares Out (Mil)	11.265
Float Shares (Mil)	N/A
Insider Ownership	47%
Institutional Holdings	53%
Annualized Dividend	\$0.56
Dividend Yield	2.1%
FCF Per Share (2019E)	\$1.43
FCF Yield (2019E)	5%
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	1,465
Russell 2000 – Last 12 Months	24.4%
OTCM – Last 12 Months	41.1%



expense as integral to fueling higher growth rates as the company expands services and introduces new product offerings. Net income of \$3.395 million increased 16% from 3Q:16, leading to EPS of \$0.29, up 14% over the prior-year period. We note that a lower tax rate of 26%, versus our 35% forecast and 32% a year ago, helped drive the beat.

Exhibit 1: OTCM 3Q:17 review					
\$ in thousands except per share data					
	3Q:16A	3Q:17A	YoY Change	3Q:17 E	Estimate Variance
Revenue	\$12,613	\$13,622	8.0%	\$13,130	3.7%
Operating Income	\$4,399	\$4,590	4.3%	\$4,714	(2.6%)
Operating Margin	34.9%	33.7%		35.9%	
Net Income	\$2,927	\$3,395	16.0%	\$3,074	
Profit Margin	23.2%	24.9%		23.4%	6.5%
EPS	\$0.26	\$0.29	14.3%	\$0.27	8.5%

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

**Solid revenue trends continue in 3Q:17, and Blue Sky exemption is now in 27 states.** While the strong revenue trends in 3Q:17 were positive, the company also announced that it has now signed 27 states that recognize the OTCQX market for Blue Sky exemption status. We note that 27 states was a tipping point for other markets to gain larger IPO transactions, and OTCM also could experience a greater rate of growth as we expect more states to continue to include the OTCQX and OTCQB for exemption status. While we think an acceleration of growth due to the 27 state exemption status is unlikely in the near term, we view it as a positive long-term driver of growth. In addition, announced in 3Q:17 were alliances with the Canadian Securities Exchange, a Canadian listing exchange, and with Issuer Direct Corporation (NYSE: ISDR, NC), a provider of communications and compliance solution to issuers. We think the later could prove significant as the company could expand service offerings over time to help drive further revenue growth. Companies added to the OTCQX and OTCQB through 3Q:17 continued at a strong pace, adding 58 and 192 companies, respectively. Companies on the OTCQX were 355 versus 387 a year ago, while 932 were on the OTCQB, up from 869 a year ago. Given the backdrop of a stronger economy and the strongest rate of Form 211 filings in seven quarters at 123, prospects for continued additions to both markets remain positive, in our view. 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 through crowdfunding. While early in the adoption of this new path to market for smaller companies, there have been several successful transactions, and we would expect over time the rate of greater adoption of Regulation A+ to increase. All in, we view OTCM's 3Q:17 results positively due to the stronger revenue growth, increase in Blue Sky exemption status and the creation of new alliances. We now forecast 2017 EPS of \$1.09, up from \$1.06, and forecast 2018 EPS up 5% year over year to \$1.14 and 2019 up 9% to \$1.24.

**OTCM has a strong balance sheet and a shareholder friendly capital allocation plan, in our view.** OTCM exited 3Q:17 with net cash of \$25 million (\$2.12 per share). 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 conjunction with the 3Q:17 earnings release, OTCM announced it would pay a \$0.60 special dividend in 4Q:17. We note the special dividend is the third-consecutive year of the \$0.60 special dividend, and the company also will pay its \$0.14 quarterly dividend. In addition, OTCM repurchased 99,302 shares through 3Q:17 for an average price of \$21.91 each. This follows 2016 when OTCM returned \$14.7 million to shareholders in the form of dividends and share repurchases, 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 \$30 target on OTCM shares.** Our target is based on applying a multiple of 24x to our 2019 EPS forecast of \$1.24. OTCM shares trade at 24x and 22x 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, the door will open for additional companies to use OTC's services.

Key Risks	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	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
<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>\$13,622</b>	<b>\$13,559</b>	<b>\$54,326</b>	<b>\$13,967</b>	<b>\$14,390</b>	<b>\$14,239</b>	<b>\$14,168</b>	<b>\$56,765</b>	<b>\$59,569</b>
Redistribution fees	593	584	557	583	2,317	624	626	584	597	2,431	670	691	669	623	2,654	2,785
<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>\$13,038</b>	<b>\$12,962</b>	<b>\$51,895</b>	<b>\$13,297</b>	<b>\$13,699</b>	<b>\$13,570</b>	<b>\$13,545</b>	<b>\$54,111</b>	<b>\$56,784</b>
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
<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>\$8,448</b>	<b>\$8,352</b>	<b>\$33,633</b>	<b>\$8,841</b>	<b>\$8,692</b>	<b>\$8,487</b>	<b>\$8,642</b>	<b>\$34,662</b>	<b>\$35,436</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>\$4,590</b>	<b>\$4,610</b>	<b>\$18,262</b>	<b>\$4,455</b>	<b>\$5,008</b>	<b>\$5,083</b>	<b>\$4,902</b>	<b>\$19,449</b>	<b>\$21,348</b>
Other income (costs)	(8)	4	11	2	8	14	22	5	10	51	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>\$4,595</b>	<b>\$4,620</b>	<b>\$18,313</b>	<b>\$4,465</b>	<b>\$5,018</b>	<b>\$5,093</b>	<b>\$4,912</b>	<b>\$19,489</b>	<b>\$21,388</b>
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)
<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>\$3,395</b>	<b>\$3,095</b>	<b>\$12,558</b>	<b>\$3,170</b>	<b>\$3,312</b>	<b>\$3,362</b>	<b>\$3,291</b>	<b>\$13,135</b>	<b>\$14,360</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>\$3,395</b>	<b>\$3,095</b>	<b>\$12,558</b>	<b>\$3,170</b>	<b>\$3,312</b>	<b>\$3,362</b>	<b>\$3,291</b>	<b>\$13,135</b>	<b>\$14,360</b>
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
<b>Growth Analysis</b>																
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%
<b>Margin Analysis</b>																
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

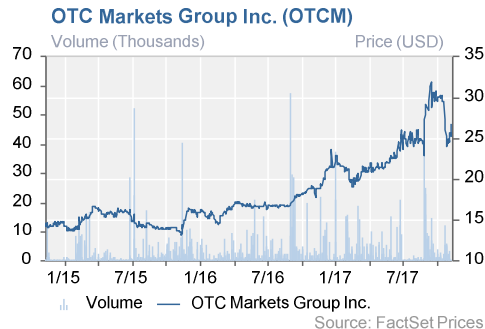
### Required Disclosures

#### Required Disclosures

**OTC Markets Group Inc. (OTCM-\$26.80) 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	
PT	9/29/17	29.8		30	



#### Key Risks

Trading liquidity

#### Valuation:

**We maintain a \$30 target on OTCM shares.** Our target is based on applying a multiple of 24x to our 2019 EPS forecast of \$1.24. OTCM shares trade at 24x and 22x 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, the door will open for additional companies to use OTC's services.

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**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 11/09/17, 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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