



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

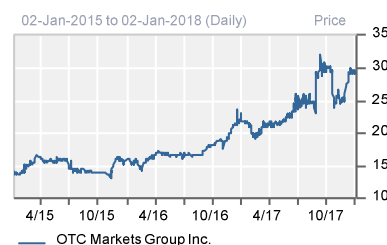
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Key Statistics

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%	21%	26%	38%	
2018 EPS	\$1.33	\$1.25	\$1.05	2019 EPS	\$1.46	\$1.37
						\$1.15

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

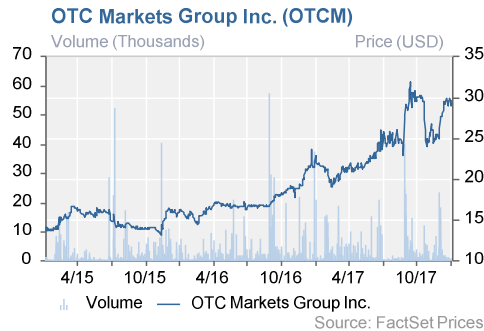
Appendix Required Disclosures

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:

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APPENDIX CONTINUED

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