

OTC Markets Group

Gaining domestic and international traction

Q318 results

OTC Markets Group's (OTCM's) Q318 results showed sound revenue growth, a pick-up in corporate client numbers and a further increase in the number of states granting Blue Sky recognition. The data-driven transparency and cost-effective proposition of OTCM's premium markets can be seen to be gaining traction and we have increased our estimates. While fluctuations in market conditions may affect quarterly progress, the long-term scope for increased penetration of international and domestic companies could provide the basis for further estimate increases.

Year end	Revenue (\$m)	PBT (\$m)	EPS* (\$)	DPS** (\$)	P/E (x)	Yield (%)
12/16	50.9	16.9	0.90	1.16	35.8	3.6
12/17	54.7	18.4	1.06	1.16	30.6	3.6
12/18e	58.6	20.0	1.36	1.24	23.8	3.8
12/19e	61.3	20.9	1.38	1.27	23.4	3.9

Note: *Fully diluted and calculated after restricted stock award allocation. **Including special declared dividends of \$0.60 for 2016 and 2017, and an estimated \$0.65 and \$0.67 for 2018 and 2019, respectively.

Q318 results

OTCM reported revenue up by 8% y-o-y. OTC Link (+16%) was helped by the contribution from the OTC Link ECN trading platform, which was launched at the end of last year. Although staff costs increased by 8%, reflecting additional headcount and increased compensation, overall expense growth was 3.5%, allowing pre-tax profits to increase by 16% to \$5.3m. A lower tax charge in the quarter (18%) resulted in diluted EPS growth of 26% to \$0.37. The quarterly dividend was maintained at \$0.15 (increased from \$0.14 at the Q218 stage) and a special dividend of \$0.65 was announced (compared with \$0.60 last year). The balance sheet remains strong, with net cash at the period end of \$26.1m.

Market background and outlook

While estimates for global and US economic growth have been quite resilient, uncertainty over the outlook could impinge on corporate and investor confidence. However, OTCM has seen a pick-up in the number of corporate clients on its premium markets and sees good potential to extend its geographical reach (international companies already account for 65% of the OTCQX index constituents). Two states have been added to the list granting Blue Sky recognition to OTCQX and OTCQB, taking population coverage to c 50%. Building on this momentum, work continues to facilitate further recognition. While this does not have a direct linkage to revenue, it is positive reputationally.

Valuation: Estimates and valuation raised again

Our EPS estimates for FY18 and FY19 have been increased by 3.8% and 1.5%, respectively, and we have raised our fair value to c \$34 versus \$31 previously (see page 9).

Financial services

15 November 2018

Price **US\$32.40**
Market cap **US\$376m**

Net cash (\$m) at end-September 2018	26.1
Shares in issue	11.6m
Free float	61%
Code	OTCM
Primary exchange	OTCQX
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	5.7	9.5	30.5
Rel (local)	8.3	15.1	24.6
52-week high/low	US\$33.0	US\$23.8	

Business description

OTC Markets Group operates the OTCQX, OTCQB and Pink financial markets for over 10,000 US and global securities. OTC Link LLC, a member of FINRA, operates OTC Link ATS and OTC Link ECN, both SEC-registered Alternative Trading Systems. Approximately 85% of revenues are of a contract-based recurring nature.

Next event

FY18 results	March 2019
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**OTC Markets Group is a
research client of Edison
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Investment summary

Business-friendly markets generating subscription revenues

OTCM's mission is to create better informed and more efficient financial markets. Sharing information on open networks creates transparency for investors, while investment in technology ensures that broker dealers are reliably connected, providing quotes on over 10,000 companies. For international and domestic corporate clients, OTCM's markets are tiered by standards of disclosure (OTCQX, OTCQB and Pink) and provide access to public trading in the US at a cost-effective price, compared with a listing on a registered national securities exchange such as Nasdaq. Approximately 87% of OTCM revenues are earned on a recurring, contractual basis rather than being transactional in nature and include annual fees paid by corporate clients on the premium OTCQX and OTCQB markets, broker-dealer subscription fees and data fees for access to pricing and other information channelled through distributors such as Bloomberg. Between 2007 and 2017, revenues grew at a compound rate of 12%.

Valuation: Trading within P/E ranges for comparators

Comparing OTCM with global exchanges and leading information providers (given their subscription-based revenues), we note that it trades on slightly below the P/E averages for these peers for FY18 and slightly above for FY19, and well within the range of valuations for these periods. Based on our DCF analysis, assumptions giving a valuation in line with the current share price would include a discount rate of 10%, long-term cash flow growth of 4% and a terminal cash flow multiple of 17.2x. Taking our peer comparison and DCF model into account, we have increased our fair value from \$31 to \$34.

Financials: Estimates increased for second quarter running

We have increased estimates for FY18 and FY19 modestly following a similar increase after the Q218 results. At the EPS level, the increases are 3.8% and 1.5%, respectively. In terms of revenue, the main driver for the current year increase is the better than expected outcome in the OTC Link division, where increased equity market volatility and increased traction for the OTC Link ECN have been the key contributors.

Sensitivities: Macro and micro

From a macro perspective, the economic background will have a positive or negative influence on equity market trends including: investor sentiment towards international and venture equities, the flow of venture company IPOs, corporate interest in accessing liquidity in the US market, and volatility and trading volumes. A range of micro factors apply specifically to OTCM and its sector, and points to consider here include the following:

- Regulation can have a positive or negative influence. For example, regulations facilitating online capital raising are expected to increase the pool of potential clients for OTCM, while regulation Systems, Compliance and Integrity (SCI) imposes costs to ensure compliance.
- Competition for corporate clients comes from national securities exchanges and could increase if they were allowed to become specialised venture exchanges. For trading, competition includes Global OTC (ICE subsidiary) and direct trading between dealers.
- Reliability of the group's IT systems is important from a reputational and regulatory perspective, and OTC Link Alternative Trading System (ATS) has established a strong record of uptime.

Transparent, efficient and technically reliable markets

OTCM began to take its current form in 1997 with the purchase of the National Quotation Bureau (NQB) by CEO R Cromwell Coulson and a group of investors. NQB published the Pink Sheets, which were an aggregation in printed form of broker dealer quotes for securities traded off-exchange. Following the purchase, the new management team began the process of applying technology to the task of aggregating liquidity and increasing transparency. A platform providing real-time quotes was launched in 2003 and evolved into the current SEC-registered OTC Link ATS. Another platform, OTC Link ECN, was launched in 2017, providing dealers with alternative features including an order-matching engine – as opposed to the ATS, where quotes are displayed and messages delivered, enabling direct trades between dealers.

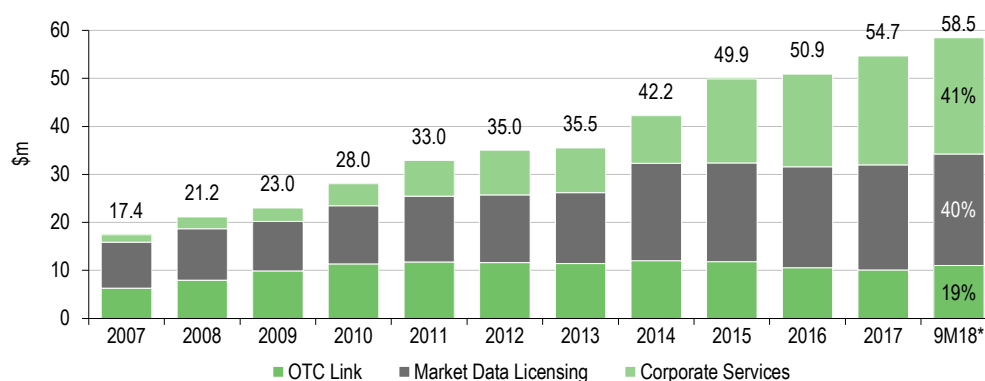
OTC Link ATS carries quotes in over 10,000 companies and has 97 active broker-dealer participants. In order to help investors assess risk exposure, the companies are organised into three tiers, with membership of each subject to levels of disclosure differentiated in terms of timeliness, quality and quantity of information provided.

- **OTCQX Best Market** companies meet high financial standards, have recognised corporate governance standards and provide timely public disclosure. At end-Q318, there were 395 OTCQX client companies.
- **OTCQB Venture Market** is intended to provide a public trading facility for developing companies that meet standards promoting price transparency and facilitate public disclosure. OTCQB companies must remain current in their disclosure and provide additional information for investors. At end-Q318, there were 953 client companies.
- The **Pink Open Market** comprises those companies quoted on the OTC Link ATS that do not meet the standards of, or chose not to apply for, the premium markets. To help give some differentiation within this market, companies are further categorised into Pink Current Information, Pink Limited Information and Pink No Information.

In Q318, approximately 87% of OTCM revenues were contract-based and of a recurring nature, reflecting the subscription model that applies in the majority of its activities. As examples, OTC Link earns monthly licence, subscription and connection fees from broker-dealers to use OTC ATS Link; Market Data Licensing distributes data through companies such as Bloomberg, Thomson Reuters and Interactive Data Corporation in exchange for end-user subscription fees; and Corporate Services earns annual subscription fees from companies that join OTCQX and OTCQB markets.

Revenues grew at a compound annual rate of 12% between 2007 and 2017, with the most rapid growth seen in Corporate Services, which accounted for 41% of the total in 9M18 (Exhibit 1).

Exhibit 1: Gross revenue evolution and analysis



Source: OTCM. Note: *9M18 annualised.

Q318 results

In Q318, OTCM recorded gross revenue growth of 8.4% y-o-y. A stepping-up of trading volumes on OTC Link ECN, launched in December 2017, fuelled a near-25% increase in fees and rebates paid, which meant that net revenue growth was slightly lower at 7.7%. Cost growth was held to below 4%, allowing pre-tax profits to increase by 16%. The reduction in US corporate tax rate and a higher research and development tax credit claimed in respect of the 2017 tax year resulted in a lower tax rate of 18%. This left net earnings and diluted EPS more than 25% ahead of the prior-year period and 10% above the second-quarter level.

The quarterly dividend (40th consecutive payment) was maintained at 15 cents following an increase from 14 cents in the second quarter. A special dividend of 65 cents was announced, five cents above the prior-year level, an increase of 8%.

Exhibit 2: Q318 results summary							
\$000s (except where stated)	Q317	Q417	Q118	Q218	Q318	y-o-y (% chg)	q-o-q (% chg)
OTC Link	2,413	2,546	2,651	2,799	2,807	16.3	0.3
Market Data Licensing	5,505	5,445	5,842	5,830	5,763	4.7	(1.1)
Corporate Services	5,704	5,898	5,849	6,137	6,195	8.6	0.9
Gross revenues	13,622	13,889	14,342	14,766	14,765	8.4	(0.0)
Redistribution fees and rebates	(584)	(646)	(629)	(710)	(728)	24.7	2.5
Net revenue	13,038	13,243	13,713	14,056	14,037	7.7	(0.1)
Operating expenses	(8,448)	(8,591)	(9,163)	(9,060)	(8,745)	3.5	(3.5)
Income from operations	4,590	4,652	4,550	4,996	5,292	15.3	5.9
Other income / net interest	5	6	17	11	51	920.0	363.6
Income before provision for income taxes	4,595	4,658	4,567	5,007	5,343	16.3	6.7
Taxes	(1,107)	(1,742)	(820)	(1,020)	(958)	(13.5)	(6.1)
Net income	3,488	2,916	3,747	3,987	4,385	25.7	10.0
Diluted EPS (\$)	0.29	0.24	0.31	0.34	0.37	25.5	9.7
Operating margin	35%	35%	33%	36%	38%		
Tax rate	24%	37%	18%	20%	18%		
Source: OTCM, Edison Investment Research							

We have included the divisional analysis of revenues in Exhibit 2 and added subdivisinal figures derived from management commentary in Exhibit 3. Apart from OTC Link ECN, the subdivisinal revenue figures are based on figures given for absolute and percentage changes and are therefore indicative, given the potential for rounding errors.

As in the second quarter, OTC Link generated the fastest growth, at 16%, followed by Corporate Services and Market Data Licensing. As can be seen in Exhibit 3, the increase in activity on the ECN accounted for the majority of growth for the **OTC Link division**. Since launch, the ECN has enabled 29 existing OTC Link ATS subscribers and added seven new users. Otherwise, the division benefited from higher messaging volume associated with more active markets, reflecting volatility and interest in cryptocurrency and cannabis-related securities. The number of broker-dealer subscribers increased slightly, but this was offset by a reduction in the number of users of OTC Dealer software and individual connection fees.

For the **Market Data Licensing division** revenues (+5%), the main positive drivers were data licence and end-of-day pricing products, which both benefited from price increases and from new sales and higher reported users, respectively. These gains substantially outweighed lower advertising revenue following difficulties in integrating a third-party provider with the new OTCM website (this has now been largely resolved).

Corporate Services revenues increased by 9% including increases of 10% and 11% for OTCQB and OTCQX, respectively. Both markets benefited from a higher average number of companies, resulting from strong new corporate client wins. For OTCQB, a higher rate of client company retention and price increases for renewing subscribers at the beginning of 2018 were additional

positive factors. OTCQX experienced a lower rate of compliance-related downgrades and also accrued accelerated revenues arising from M&A and when companies graduated to exchanges or cancelled for other reasons.

Exhibit 3: Indicative subdivisional revenue analysis					
\$000	Q317	Q318	Absolute change	% change	% group
OTC Link					
ECN	0	284	284	N/A	2%
Trade messages	708	793	85	12%	5%
Other	1,705	1,730	25	1%	12%
Total	2,413	2,807	394	16%	19%
Market Data Licensing					
Advertising	112	30	-82	-73%	0%
Non-professional users	383	406	23	6%	3%
End of day pricing product	455	605	150	33%	4%
Data licence products	561	735	174	31%	5%
Other	3,994	3,987	(7)	0%	27%
Total	5,505	5,763	258	5%	39%
Corporate Services					
OTCQB	2,780	3,058	278	10%	21%
OTCQX	1,873	2,079	206	11%	14%
Other	1,051	1,058	7	1%	7%
Total	5,704	6,195	491	9%	42%
Group gross revenues	13,622	14,765	1,143	8%	100%
Source: OTCM, Edison Investment Research. Note: subdivisional revenue numbers are inferred from the absolute and percentage changes reported but are only indicative because of rounding effects.					

Exhibit 4 provides a summary of OTCM's operating data and derived revenue measures. We highlight the following points:

- The number of active participants for OTC Link increased slightly for the second quarter running, marking a stabilisation of the downward trend seen previously (from 133 in 2012) as broker dealers consolidated or withdrew in the face of pressures including increased automation/commoditisation of services and the costs of regulatory compliance.
- The number of companies on OTCQX rose by over 11% y-o-y and 8% sequentially. As noted, a good level of sales was combined with lower compliance downgrades this year, following the increase seen in 2017 linked to changes in eligibility standards that took effect at the beginning of that year. International companies accounted for a significant part of the sequential growth in this quarter and this is seen as an important area for development (see outlook section).

Exhibit 4: Operating and related revenue data							
	Q317	Q417	Q118	Q218	Q318	y-o-y % chg	q-o-q % chg
OTC Link							
Number of securities quoted	9,991	10,286	10,448	10,476	10,121	1.3	(3.4)
Number of active participants	94	94	94	95	97	3.2	2.1
Revenue per security quoted (\$)	242	248	254	267	277	14.8	3.8
Revenue per average active participant (\$)	25,267	27,085	28,202	29,619	29,240	15.7	(1.3)
Corporate Services							
Number of corporate clients							
OTCQX	355	366	358	365	395	11.3	8.2
OTCQB	923	938	951	922	953	3.3	3.4
Pink	727	755	756	761	736	1.2	(3.3)
Total	2,005	2,059	2,065	2,048	2,084	3.9	1.8
Revenue per client (\$)	2,845	2,864	2,832	2,997	2,973	4.5	(0.8)
Graduates to a national securities exchange	12	24	21	20	16	33.3	(20.0)
Market Data Licensing							
Market data professional users	20,512	20,390	20,557	20,951	20,991	2.3	0.2
Market data non-professional users	14,012	14,801	15,726	15,389	14,661	4.6	(4.7)
Revenue per terminal (total - \$)	159	155	161	160	162	1.4	0.8
Source: OTCM, Edison Investment Research							

OTCM has maintained its strategic emphasis on providing **data-driven transparency** in its premium markets. In addition to refining rules for its premium markets, it has taken steps to increase the availability of information for investors. These include its Transfer Agent Verified Shares Scheme, launched in 2016, that provides timely information on share issuance and share count, helping to alert shareholders to potential dilution of their interest. The number of agents participating has risen progressively and there are now 30 (22 at the time of the Q218 report), giving coverage of about 96% of companies on the OTCQX and OTCQB markets. OTCM also introduced stock promotion and shell flags recently and has added them to compliance data files that compliance departments can use to monitor risks. OTCM has now extended this by introducing a Small Cap Listed Compliance product, which provides a framework for monitoring data across both the listed and OTC small cap equity markets. The company reports that, at the beginning of October, 27 companies were subscribing to its compliance data or analytics products including many of the largest banks, custodian and clearing firms: an encouraging indicator that subscription to these services is becoming a default option for such companies.

The number of states that grant **Blue Sky recognition** to OTCQX and OTCQB has continued to tick up, with Missouri and Oklahoma added since the Q218 report, taking the total recognising OTCQX to 33 and OTCQB to 30 (see Exhibit 5 below). OTCQX coverage now includes states accounting for about 50% of the population in the US. Michigan is in the process of considering giving recognition and, were it to do so, this would increase the population coverage to 53%.

The North American Securities Administrators Association (NASAA) in July announced a **model rule proposal** for states to employ that would have the effect of granting OTCQX/OTCQB recognition. There was a period for comments that closed in August with only supportive submissions received. OTCM has noted that adoption of the model rule would be likely to facilitate a number of states moving towards Blue Sky recognition of its markets.

Exhibit 5: Blue Sky recognition for OTCQX and OTCQB

Alaska	Louisiana	Pennsylvania
Arkansas	Maine	Rhode Island
Colorado	Minnesota	South Dakota
Connecticut	Mississippi	Tennessee
Delaware	Missouri	Texas
Georgia	Nebraska	Utah
Hawaii	New Jersey	Vermont (OTCQX only)
Idaho (OTCQX only)	New Mexico	Washington
Indiana	Ohio	West Virginia
Iowa	Oklahoma	Wisconsin
Kansas (OTCQX only)	Oregon	Wyoming

Source: OTCM

Background and outlook

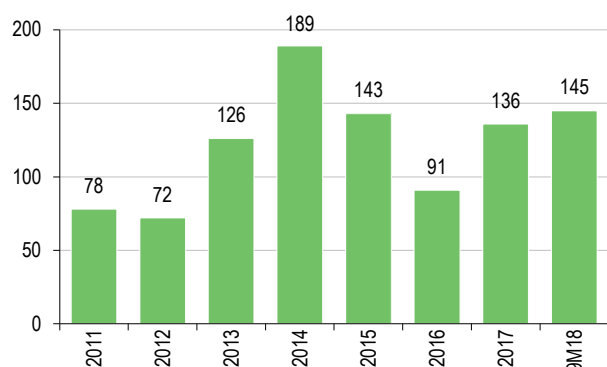
We start by considering the equity capital markets background as an indicator of the background for OTCM. While global economic forecasts have only seen small downward adjustments in recent months, commentators such as the OECD highlight increased uncertainty relating to trade tensions and normalisation of monetary policy, notably in the US. These factors are likely to have contributed to the recent correction in equity market prices, which is evident in the negative returns over three months for a range of indices, shown in Exhibit 6. Looking at the year-to-date figures, OTCQX and OTCQB indices have been significantly weaker than the broad US indices, which can be seen as reflecting a combination of the small- and mid-cap and Canadian components of its constituents: areas where weakness has been more marked. The strength of the US dollar in this period will also have been a factor influencing the US\$ prices of international stocks in the OTCM indices.

Exhibit 6: Recent market index performance (total return %)

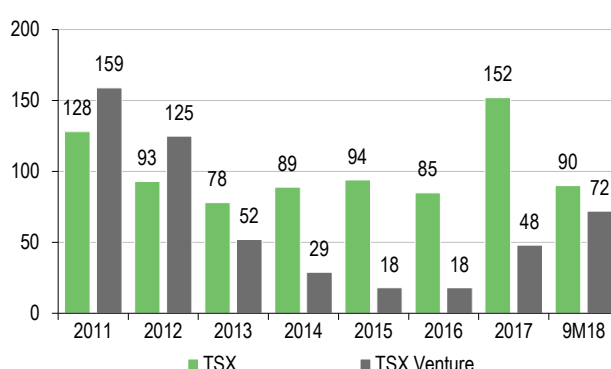
Period	S&P 500	Nasdaq Composite	OTCQX Composite	OTCQB	S&P TSX Venture	AIM All Share
	US\$	US\$	US\$	US\$	C\$	GB£
3m	(3.1)	(5.9)	(8.0)	(2.6)	(6.0)	(8.6)
6m	3.8	2.2	(11.3)	(3.1)	(14.5)	(6.4)
1y	7.9	9.5	3.8	(8.2)	(16.5)	(3.8)
Year to date	4.0	7.1	(12.8)	(18.9)	(22.3)	(4.5)

Source: Bloomberg. Note: priced on 6 November 2018.

We monitor the number of IPOs on Nasdaq, the Canadian TSX and TSX Venture exchanges as an indicator of corporate and market confidence and activity. For Nasdaq, the number of IPOs to end-September was 66% ahead of the same period last year, while on the Canadian exchanges TSX IPOs were just ahead and TSX Venture was running at more than double the number in the prior-year period. While these appear to be positive indicators, the increase in equity market volatility in October may mean corporate activity levels are more subdued in the near term and, arguably, this could also influence the timing of OTCM's sales pipeline.

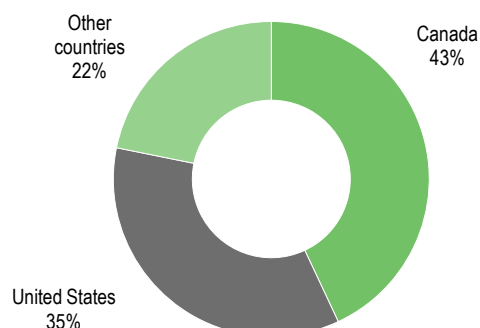
Exhibit 7: Nasdaq – number of IPOs


Source: Nasdaq

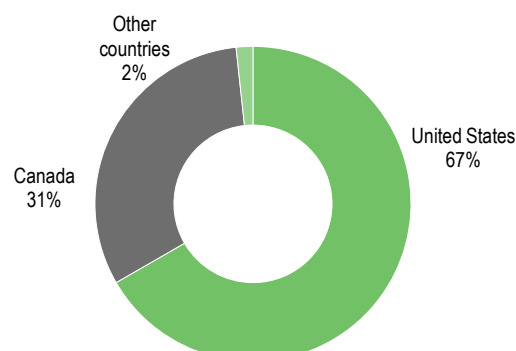
Exhibit 8: TSX and TSX Venture – number of IPOs


Source: TMX

OTCM has highlighted success in winning international clients for its premium markets in the latest quarter. Its OTCQX and OTCQB markets can offer a complementary service facilitating cost-effective access to a US investor base and enhanced liquidity for international companies with primary listings elsewhere. The current geographical make-up of OTCQX and OTCQB indices is shown in Exhibits 11 and 12.

Exhibit 11: OTCQX Composite Index constituents


Source: OTCM. Note: % of 330 constituents 7/11/18 (395 companies on OTCQX end September 2018).

Exhibit 12: OTCQB Venture Index constituents


Source: OTCM. Note: % of 702 constituents 7/11/18 (953 companies on OTCQB end September 2018).

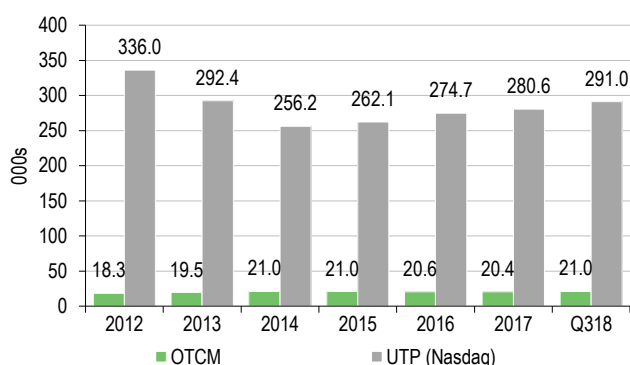
This shows the significant share of Canadian companies in both indices (helped in part by OTCM's partnership with the Canadian Securities Exchange) and that international securities as a whole already account for 65% of the OTCQX index. For both markets there would seem to be significant

potential to broaden the geographical breadth of the client base over time and the group is continuing to commit resources to international marketing and has announced that it will open a small office in London to provide a base for sales across Europe. OTCM is also very active in addressing markets in Asia and Australia.

On a medium- and longer-term view, OTCM sees potential benefits from the development of online or crowdfunded capital raising facilitated by Regulation A+ and Regulation Crowdfunding. The development of online funding could create a larger pool of companies that may be attracted to OTCM's cost-effective market offering for secondary trading. In May, the passage of the Economic Growth, Regulatory Relief and Consumer Protection Act (S.2155) is set to extend the availability of Regulation A+ to SEC reporting companies; this section of the act largely reflected OTCM's SEC petition for rulemaking. SEC rule changes that will influence the impact of the act are still awaited.

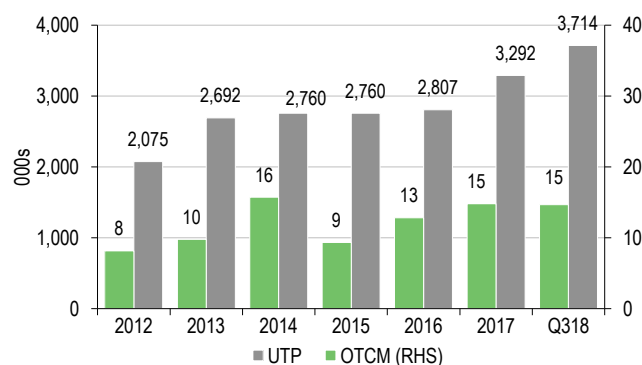
Next, we look at the trends in subscribers to market data; Exhibits 9 and 10 show figures for professional and non-professional users for OTCM and Nasdaq. Encouragingly, the number of professional users (the larger source of revenue for the Market Data Licensing division) has increased from the first quarter of this year, although it should be remembered that user numbers have tended to fluctuate on a quarterly basis, partly driven by audits of distributor subscriber numbers. The non-professional user numbers have risen y-o-y and significantly since 2012, albeit with variations, as shown in Exhibit 10. The small size of OTCM's user base relative to Nasdaq underlines the opportunity to expand this source of revenue as the company continues to build its corporate client base and strengthens the reputation of its premium markets.

Exhibit 9: OTCM and UTP (Nasdaq) professional users



Source: OTCM, UTP Plan, Edison Investment Research

Exhibit 10: OTCM and UTP non-professional users



Source: OTCM, UTP Plan, Edison Investment Research

Other points we would highlight when considering the outlook for OTCM are as follows:

- Adoption of the NASAA model rule should facilitate further additions to states granting OTCM markets Blue Sky recognition. While not directly influencing revenues, increasing recognition moves OTCM towards 100% coverage, increasing the utility of OTCM's offering to corporates and enhancing the reputation of the OTCQX and OTCQB markets.
- OTCM has highlighted that the market OTC Link ECN is addressing is limited in size and that it may need to adopt more aggressive pricing in order to gain share. While the ECN appears to be gaining share with its current pricing regime and the features it offers (including fully anonymous orders and integration with OTC Link ATS), there is potential for revenue and profitability to be affected if OTC Link ECN or competitor Global OTC decide to adjust pricing. Global OTC's market share has recently fluctuated around a level of 10%, although in the first part of November has been close to 13%.
- OTCM's expenses are set to increase in FY19 as it moves into a new main office in New York. In our forecast (see next section), we assume that this will add approximately \$0.5m to occupancy costs. The company expects to move in by mid-2019. The sublease expires in 2031 and provides 33,000 square feet of space.

Financials

Exhibit 13 summarises the changes in key numbers within our FY18 and FY19 estimates following the Q318 result. There is a modest revenue increase, mainly reflecting the better than expected result from OTC Link. We have assumed the 18% Q3 tax rate increases to 20% in subsequent quarters, so the EPS estimate increase is more muted in FY19 than for FY18.

Exhibit 13: Estimate revisions

	Gross revenue (\$m)			PBT (\$m)			EPS (\$)			Dividend (\$)		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
2018e	58.2	58.6	0.7	19.5	20.0	2.6	1.31	1.36	3.8	1.20	1.24	3.3
2019e	60.7	61.3	0.9	20.6	20.9	1.7	1.36	1.38	1.5	1.25	1.27	1.6

Source: Edison Investment Research. Note: dividends include the declared and estimated special dividends of 65c and 67c for FY18 and FY19, respectively.

Cash available for operations at end-September stood at \$26.1m compared with \$25m at end-June and \$23.7m at end-2017. This excluded restricted cash (held as clearing collateral) and including this total cash stood at \$27.8m. For the year-end, we estimate cash and restricted cash of \$22.7m following payment of the special dividend and an increase in capital spending related to the prospective office move. As mentioned in our last note in [August](#), part of this cash together with borrowing could provide the means for a significant acquisition should a suitable opportunity arise in an area serving OTCM's client base in small- and mid-cap corporates.

Valuation

We have updated our comparative P/E table (Exhibit 14), which includes major information providers MSCI and Markit (in recognition of OTCM's subscription-based fees and market data exposure), together with global exchange averages and values for the S&P 500 index. OTCM trades within the range for the information providers and is trading above the FY18e and FY19e average P/Es for the exchanges (although well within the range of multiples for these companies). Given OTCM's potential to increase its penetration with both domestic and international corporates and to leverage its liquid balance sheet, there should be good scope for positive surprises in earnings over the medium to longer term, helping to justify the current rating.

Exhibit 14: OTCM comparative multiples

	Estimated P/E ratios (x)	
	FY18e	FY19e
MSCI	28.4	25.1
Markit	22.5	20.1
Average information providers	25.5	22.6
Average global exchanges	24.8	21.6
S&P 500	16.7	15.3
OTCM	23.8	23.4

Source: Bloomberg, Edison Investment Research. Note: prices as at 13 November 2018.

Using our discounted cash flow model to determine a set of assumptions that would match the current share price, we find that a discount rate of 10%, long-term cash flow growth of 4% and a terminal cash flow multiple of 17.1x (arguably not excessive in comparison to the current year value of c 26x) would give a valuation in line with the share price at the time of writing (\$32.40, 13 November 2018). A sensitivity table shows the variation in implied valuation with changes in growth and discount rate assumptions.

Exhibit 15: Discounted cash flow valuation sensitivity (\$ per share)

Discount rate (right) 2020–28e growth	8%	9%	10%	11%	12%
3%	35.1	32.8	30.8	28.9	27.2
4%	37.0	34.6	32.4	30.4	28.5
5%	39.0	36.4	34.1	31.9	30.0
6%	41.2	38.4	35.9	33.6	31.5

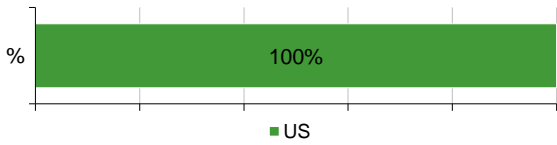
Source: Edison Investment Research

Taking into account the comparative valuations shown above and the potential DCF outputs on a range of assumptions, we see a fair value of c \$34 as reasonable (previously c \$31).

Exhibit 12: Financial summary

\$000s	2015	2016	2017	2018e	2019e
Year end 31 December					
PROFIT & LOSS					
OTC Link	11,796	10,573	10,074	10,957	11,050
Market Data Licensing	20,610	21,054	21,922	23,235	24,388
Corporate Services	17,503	19,254	22,660	24,406	25,838
Revenue	49,909	50,881	54,656	58,598	61,275
Re-distribution fees and rebates	(2,379)	(2,317)	(2,480)	(2,796)	(3,094)
Net revenue	47,530	48,564	52,176	55,802	58,181
Operating expenses	(28,972)	(30,032)	(32,511)	(34,911)	(36,338)
EBITDA	18,558	18,532	19,665	20,891	21,844
Depreciation	(1,692)	(1,606)	(1,361)	(1,042)	(1,065)
Operating profit (before amort. and except).	16,866	16,926	18,304	19,849	20,779
Net interest	27	9	47	109	133
Profit Before Tax (norm)	16,893	16,935	18,351	19,958	20,911
Tax	(6,635)	(6,407)	(5,792)	(3,806)	(4,182)
Profit after tax	10,258	10,528	12,559	16,152	16,729
Profit after tax and allocation to RSAs	9,971	10,252	12,241	15,746	16,297
Average Number of Shares Outstanding (m)	11.3	11.3	11.6	11.6	11.8
EPS - basic (c)	90.6	92.4	109.9	139.1	141.2
Fully diluted EPS (c)	88.3	90.4	105.8	136.1	138.2
Dividend per share (c)	108.0	116.0	116.0	124.0	127.0
EBITDA Margin (%)	39	38	38	37	38
Operating profit margin (%)	35	35	35	36	36
BALANCE SHEET					
Non-current assets					
Intangible assets	291	291	362	324	324
Property and other	4,187	3,267	3,506	4,249	4,089
Current assets					
Debtors	6,082	6,262	6,450	6,233	6,233
Cash & cash investments	23,925	25,034	23,683	21,136	26,254
Other current assets	1,729	1,789	2,316	2,502	2,602
Current liabilities					
Deferred revenues	(12,737)	(14,664)	(15,531)	(11,413)	(12,000)
Other current liabilities	(5,063)	(5,372)	(5,644)	(5,140)	(5,140)
Long-term liabilities					
Tax, rent and other	(867)	(1,101)	(1,351)	(1,463)	(1,463)
Net assets	17,547	15,506	13,791	16,428	20,899
NAV per share (\$)	1.55	1.36	1.21	1.42	1.81
CASH FLOW					
Operating cash flow	22,400	21,752	21,629	17,696	24,831
Net Interest	27	9	47	109	133
Tax	(5,320)	(6,021)	(5,193)	(2,683)	(4,182)
Capex / intangible investment	(940)	(415)	(1,165)	(935)	(905)
Financing / investments	(420)	(1,157)	(3,407)	(2,544)	(100)
Dividends	(12,094)	(13,059)	(13,262)	(14,190)	(14,658)
Net cash flow	3,653	1,109	(1,351)	(2,547)	5,118
Opening net (debt)/cash	20,272	23,925	25,034	23,683	21,136
Closing net (debt)/cash	23,925	25,034	23,683	21,136	26,254
Cash and restricted cash	24,135	25,244	24,375	22,694	27,812

Source: OTC Markets Group accounts, Edison Investment Research

Contact details	Revenue by geography
304 Hudson Street 3rd Floor New York NY 10013 US +1 (212) 896 4400 www.otcmarkets.com	 <p>■ US</p>
Management team	
CEO, president, director: R Cromwell Coulson In 1997, Cromwell led a group of investors in acquiring OTCM's predecessor business, the National Quotation Bureau (NQB). Prior to this, Cromwell was an institutional trader and portfolio manager in distressed and value-oriented investments.	CFO: Beatrice (Bea) Ordenez Bea joined OTCM as CFO in 2015. She has more than 20 years of experience in the financial services industry including 13 years as COO and MD at Convergenx, a global brokerage and trading-related services provider. She is a qualified chartered accountant (ICAEW) and worked at Arthur Andersen and PwC.
General counsel: Dan Zinn Dan Zinn joined in November 2010. Prior to joining OTCM, he was a partner at The Nelson Law Firm, LLC, and was outside counsel to the company. Dan previously worked in the corporate office of the American International Group (AIG).	Chairman: Neal Wolkoff Neal Wolkoff is a former executive of three exchanges (including being former chairman and CEO of AMEX and an executive officer at NYMEX). He is a consultant and attorney focusing on futures and securities markets, exchanges, market regulation, operations and clearing houses.
Principal shareholders	(%)
Officers and directors	38.1
Including R Cromwell Coulson	30.4
T Rowe Price	3.5
Horizon Kinetics	1.0
Companies named in this report	
MSCI, Markit, Nasdaq	

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