

OTC Markets Group

Q319 results

Revenue progress across group

OTC Market's (OTCM) third-quarter results were consistent with our expectations and showed healthy revenue progress in each segment. This is a year of investment for the group in people, IT, a new headquarters and acquired businesses. Earnings are set to fall as a result, but we expect growth to resume in FY20 with longer-term benefits also likely to flow from the enhanced capabilities and infrastructure.

Year end	Revenue (\$m)	PBT (\$m)	EPS* (\$)	DPS** (\$)	P/E (x)	Yield (%)
12/17	54.7	18.4	1.06	1.16	32.1	3.4
12/18	59.3	19.8	1.36	1.23	24.9	3.6
12/19e	62.8	18.1	1.26	1.25	27.0	3.7
12/20e	66.6	21.0	1.42	1.33	23.9	3.9

Note: *Fully diluted and calculated after restricted stock award allocation. **Including special dividends declared and estimated of 60c, 65c, 65c and 73c for FY17–20e, respectively.

Q319 results and new strategic alliance

OTCM's Q319 results showed revenues ahead 7% y-o-y with growth in all three segments (OTC Link, Market Data Licensing and Corporate Services). Investment in personnel and IT, higher rental costs following the move to a new HQ and costs associated with acquired businesses all contributed to a 17% increase in operating expenses. This meant profit before tax was 11% lower and net profit down 8% after a lower tax rate. With the results, OTCM announced it had entered into a strategic alliance with North Capital Investment Technology to provide companies with access to a cost-effective technology platform to enable them to manage online securities offerings, an area expected to develop substantially in the long-term.

Market background and outlook

US equity markets have shown strong gains year to date, but the macro background still has considerable uncertainties and venture markets have been much weaker, potentially acting as a near-term dampener for corporate activity in this area. Looking ahead, OTCM continues to focus on developing its transparent markets and offering additional or enhanced products/services to its corporate clients, data users and broker-dealer subscribers. A study by PwC has indicated that exchange-listed companies' annual costs related to their listing run at between \$1–2m, whereas companies on OTCQX and OTCQB typically spend between \$50,000 and \$300,000. Given this differential, the potential to broaden OTCM's international client base and to address the opportunity provided by development of online fund-raising appears substantial.

Valuation: Estimate and valuation stable

Our earnings expectations for FY19 and FY20 are essentially unchanged. OTCM shares trade on prospective P/Es slightly lower than the global exchanges, and more markedly below those for information providers. Our fair value is unchanged at \$37 per share.

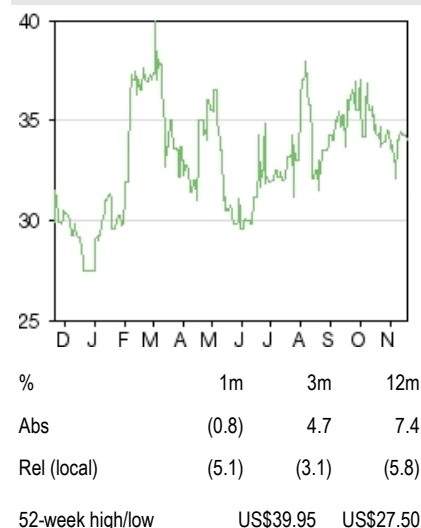
Financial services

19 November 2019

Price **US\$34.0**
Market cap **US\$396m**

Net cash (\$m) at 30 September 2019	25.8
Shares in issue	11.7m
Free float	62%
Code	OTCM
Primary exchange	OTCQX
Secondary exchange	N/A

Share price performance



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 87% of revenues are of a subscription-based recurring nature.

Next events

Q419 results	March 2020
--------------	------------

Analysts

Andrew Mitchell	+44 (0)20 3681 2500
Martyn King	+44 (0)20 3077 5745

financials@edisongroup.com
[Edison profile page](#)

**OTC Markets Group is a
research client of Edison
Investment Research Limited**

Investment summary

Earning subscription revenues, operating efficient markets

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 based on the adequacy and timeliness of disclosure, financial criteria and adherence to governance standards (OTCQX, OTCQB and Pink). They 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 subscription-based rather than transactional 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, compliance and other information. Between 2008 and 2018, revenues grew at a compound rate of 11%. Market data are primarily channelled through distributors such as Bloomberg.

Valuation: P/E multiples below global exchanges

OTCM trades on prospective P/E ratios modestly below the global exchanges, but at a larger discount to major information providers that share OTCM's subscription-based revenue emphasis. Our DCF-based fair value of \$37 per share factors in a discount rate of 10%, long-term growth of 4% and a terminal cash flow multiple of 21x.

Financials: Estimates stable, financial position strong

Our estimates are effectively unchanged following the Q319 results. The current year is one of investment in IT and personnel to support the sustainability and growth of the business, so we are estimating full year earnings to be down by 8% before growth resumes in 2020 (+13% on our forecast). The balance sheet remains strong with no debt and cash of \$25.8m at end September.

Sensitivities: Market, regulatory and operational

- 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.
- 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) requires ongoing technology investment to ensure compliance.
- Reliability of the group's IT systems is also important from a reputational perspective and OTC Link Alternative Trading System (ATS) has established a strong record of uptime in its core systems.
- 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.

Transparent and cost-effective OTC markets

The purchase of the National Quotation Bureau (NQB) by CEO R Cromwell Coulson and a group of investors in 1997 began the process that led to the creation of OTCM in its current form. NQB, with a history dating back to 1913, published the Pink Sheets, a printed list of broker-dealer quotes for securities traded off-exchange. Following the purchase, the new management team progressively applied technology to the task of aggregating liquidity and increasing transparency in this over-the-counter market.

A platform providing real-time quotes was launched in 2003 and evolved into the current SEC-registered Alternative Trading System, OTC Link ATS. Another platform, OTC Link ECN, was launched in 2017, providing dealers with complementary features including an anonymous order-matching engine with an order routing capability – as opposed to OTC Link ATS, where attributable quotes are displayed and messages delivered, enabling direct trades between dealers and competitor, Global OTC, which operates a lit order book. OTC Link ATS carries quotes in more than 10,000 companies and has 90 active broker-dealer participants, while OTC Link ECN has a growing subscriber base that stood at 47 at end September.

In order to help investors assess risk exposure, OTCM organises the companies on its markets into tiers, with membership of each subject to the adequacy and timeliness of disclosure, financial criteria and adherence to governance standards.

- **OTCQX Best Market** companies meet high financial standards, have recognised corporate governance standards and provide timely public disclosure. At end-Q319, there were 436 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-Q319, there were 915 client companies.
- The **Pink Open Market** comprises those companies quoted on the OTC Link ATS that do not meet the standards of, or choose 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.

Approximately 87% of OTCM revenues are contract-based and of a recurring nature, reflecting the subscription model that applies in the majority of its activities. Examples of this are shown in Exhibit 1 below, including subscriptions paid by broker-dealers using OTC Link ATS, market and compliance data subscriptions and annual fees charged to corporate clients on OTCQX/OTCQB.

Exhibit 1: Revenue generation, examples by segment

Segment	Comments
OTC Link	
OTC Link ATS	Broker-dealers pay subscriptions and usage fees related to the number of quotes and messaging volume.
OTC Link ECN	Fees are transaction-based with rebates for liquidity provision (maker-taker structure).
Market Data Licensing	Users subscribe to licences for market data, compliance data, company data, and security information collected by OTC Link and Corporate Services. Users include investors, traders, institutions, accountants and regulators. Most market data are sold through distributors such as Bloomberg, to which rebates (c 10%) are paid.
Corporate Services	
OTCQX, OTCQB	Corporates pay application and annual or semi-annual subscription fees.
Other	The OTC Disclosure & News Service and Virtual Investor Conferences revenues are usage dependent.

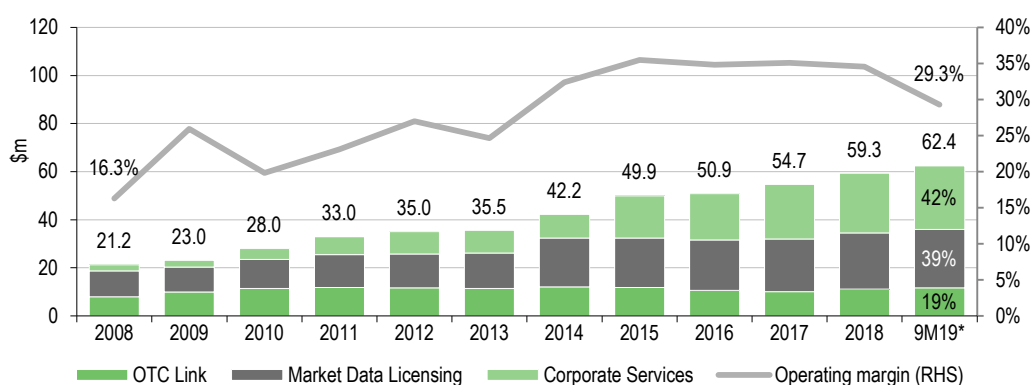
Source: OTCM, Edison Investment Research

Exhibit 2 shows the evolution of OTCM's revenue since 2008. Between 2008 and 2018, overall revenue increased at a compound rate of 11%. Within this, the most rapid growth has been in

Corporate Services (CAGR 25%), primarily reflecting development of the OTCQX and OTCQB premium markets both in terms of the number of companies subscribing and the level of fees commanded. This segment accounted for 42% of revenues in 9M19, followed by Market Data Licensing, 39%, and OTC Link, 19%.

The chart also shows the development of the operating margin. This has dipped below 30% in the current year but is still approaching double the level seen in 2008, reflecting the benefits of the growth in scale that has taken place. The flattening out in margin, at around 35%, from 2015 to 2018 can be attributed to investment in staff and IT to underpin the sustainability and further growth of the business. The reduction in the year to date margin reflects further investment in people and systems, together with the move to a new HQ and the assumption of costs associated with acquisitions. The reliability of the firm's infrastructure is very important from a reputational and regulatory perspective, and the fact that 2019 marks the fifth year of 100% uptime for OTC Link ATS's core systems demonstrates the value of work that has been done on this front.

Exhibit 2: Gross revenue and operating margin since 2008



Source: OTCM. Note: *9M19 annualised.

Strategy: Consistent focus on better informed and more efficient markets

OTCM management takes a long-term view of the development of the business and has a consistent mission statement, which is to create better informed and more efficient markets. Flowing from this is a threefold strategy set out as follows:

- Share information widely through open networks that foster transparency.
- Connect broker-dealers, organise markets and inform investors.
- Deliver elegant, reliable and cost-effective, subscription-based technology solutions.

This focus has contributed to the long-term growth in the group set out above and the goals appear to mesh well with the requirements of corporates, investors, broker-dealers and regulators involved in the OTC market.

In line with this strategy, OTCM set itself five main objectives at the beginning of 2019: (1) gain market share for OTC Link ECN; (2) ensure reliability of core systems; (3) win further regulatory recognition of the two premium markets; (4) enhance the corporate client experience; and (5) expand the product offering through acquisitions. Progress has been made on each of these targets.

On acquisitions, OTCM has been clear that it is not seeking a high-risk transformative transaction but rather to add businesses that fit with the existing activities, are relatively asset light and are earnings accretive reasonably quickly. The purchase of Virtual Investor Conferences (related assets acquired last year) and Qaravan (February this year) are examples of the type of addition the group seeks. Virtual Investor Conferences provides a time-efficient way for corporates to engage with investors or potential investors, while Qaravan provides risk and performance analytics designed to

fit the needs of the roughly 5,000 small and mid-tier public and private banks in the US. Neither is expected to have a material impact on revenues in the short term, but both already assist by broadening the product offering to existing clients and establishing relationships with new clients.

OTCM continues to work towards further regulatory recognition for its two premium markets, including progressively extending the list of states that grant exemptions under state Blue Sky laws governing secondary trading. The list currently includes 36 states for OTCQX and 33 for OTCQB (see Exhibit 3). As a result, population coverage is 55% and over 53%, respectively. In 2018, the North American Securities Administrators Association (NASAA) published a model rule proposal for states to employ that would have the effect of granting OTCQX/OTCQB Blue Sky recognition. There is no timetable for its formal adoption, but OTCM has noted this would be likely to facilitate a number of additional states moving towards recognition of its markets. Blue Sky recognition is not directly linked to revenue generation but progress towards 100% coverage should be increasingly positive reputationally, helping to attract a broader range of corporate clients to OTCM's premium markets.

OTCM is also seeking recognition for OTC securities on its OTCQX and OTCQB markets for the purposes of federal regulations dealing with margin eligibility and employee stock ownership plans.

Exhibit 3: States that have granted Blue Sky recognition for OTCQX and OTCQB

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

Source: OTCM

Q319 results meet expectations

OTCM's third quarter results continued the trends seen in the second quarter and were in line with our expectations. A summary of the profit and loss figures is given in Exhibit 4 and we pick out a number of key points below (comparisons are year-on-year unless stated).

- **Revenues** were ahead in all three segments, with the total up 7%. Sequential changes were limited.
- As in the previous quarter, investment in IT and personnel, the costs associated with the move to a new head office and costs in acquired businesses have pushed up **operating expenses**, which increased by 17%.
- This meant **profit before tax** was 11% lower at \$4.75m, but with modestly lower costs q-o-q pre-tax profit was 7% higher sequentially.
- The effective tax rate was lower than we estimated at 15% versus 18% Q318, moderating the reduction in **net profits** to 8%, while q-o-q the increase was 13%.
- OTCM declared a maintained quarterly dividend of \$0.15 and a special dividend of \$0.65 (matching the prior year). For 9M19, **cash returns to shareholders** including dividends paid and treasury share purchases were \$6.6m compared with \$6.0m for 9M18, while for FY19 we estimate a figure of nearly \$16.0m compared with \$15.2m (+5%).

Exhibit 4: Q319 results summary

\$000s unless stated	Q318	Q418	Q119	Q219	Q319	y-o-y % change	q-o-q % change
OTC Link	2,807	2,918	2,843	2,898	2,989	6.5	3.1
Market Data Licensing	5,763	5,949	6,071	6,077	6,085	5.6	0.1
Corporate Services	6,195	6,538	6,442	6,695	6,682	7.9	(0.2)
Gross revenues	14,765	15,405	15,356	15,670	15,756	6.7	0.5
Re-distribution fees and rebates	(584)	(609)	(626)	(637)	(602)	3.1	(5.5)
Net revenue	14,181	14,796	14,730	15,033	15,154	6.9	0.8
Transaction-based expenses	(144)	(147)	(140)	(172)	(219)	52.1	27.3
Revenues less transaction-based expenses	14,037	14,649	14,590	14,861	14,935	6.4	0.5
Operating expenses	(8,745)	(9,842)	(10,568)	(10,434)	(10,211)	16.8	(2.1)
Income from operations	5,292	4,807	4,022	4,427	4,724	(10.7)	6.7
Other income/net interest	51	37	37	23	26	(49.0)	13.0
Income before provision for income taxes	5,343	4,844	4,059	4,450	4,750	(11.1)	6.7
Taxes	(958)	(726)	(512)	(883)	(730)	(23.8)	(17.3)
Net income	4,385	4,118	3,547	3,567	4,020	(8.3)	12.7
Diluted EPS (\$)	0.37	0.34	0.30	0.30	0.34	(8.7)	12.6
Operating margin	37%	32%	27%	29%	31%		
Tax rate	18%	15%	13%	20%	15%		

Source: OTCM, Edison Investment Research

Our next table summarises OTCM's commentary on contributors to revenue progression within each segment. At **OTC Link**, the main driver was the continued growth in subscribers and activity on the OTC Link ECN platform, which accounted for 14% of the segment's revenue in Q319, although this falls to 7% if we deduct the rebates paid to subscribers providing liquidity (transaction-based expenses in Exhibit 4). For **Market Data Licensing**, increased take-up of compliance and data analytics products was the largest contributor to growth and at 1 November there were 41 custodian, bank and broker-dealer compliance file users compared with 33 at 1 August this year. The healthy growth in **Corporate Services** revenue mainly arose from an increase in the number of companies on OTCQX and the impact of an earlier price increase at OTCQB. Virtual Investor Conferences made a modest contribution in its first nine months as part of the group, but has been active in this period hosting 14 virtual conferences which reached nearly 12,000 investors.

Exhibit 5: Sub-divisional analysis of gross revenue changes

\$000s unless stated	Q319 revenue	Absolute change	Change %	9M19 revenue	Absolute change	Change %	Comments
OTC Link							
OTC Link ECN	424	140	49%	1,073	534	99%	New subscribers & increased trading volume
OTC Link ATS quotes		42			112		Securities traded & no. Q319 trading days up
OTC Link ATS trade messages		22			(83)		
Other		(22)			(89)		Decrease in number of active broker-dealers
Total	2,989	182	6%	8,730	474	6%	
Market Data Licensing							
Professional users		36			332		Growth in registered users through distributors
Internal delayed & other data services		141			412		Increased compliance and data analytics product sales
Broker-dealer licences		80			130		Two subscribers added in Q2
Other		65			(76)		
Total	6,085	322	6%	18,233	798	5%	
Corporate Services							
OTCQB	2,860	110	4%	9,531	706	8%	Mainly result of price increase for renewals on anniversary dates starting from 1/1/18
OTCQX	2,342	323	16%	6,609	862	15%	Net increase in no. of companies on market
Virtual Investor Conferences	61	61	N/A	224	224	N/A	Acquisition of platform January 2019
Other	1,419	(7)	0%	3,455	(154)	-4%	
Total	6,682	487	8%	19,819	1,638	9%	
Group total	15,756	991	7%	46,782	2,910	7%	

Source: OTCM, Edison Investment Research. Note: Some sub-divisional revenue numbers are inferred from the absolute and percentage changes reported and are therefore only indicative because of rounding effects.

Exhibit 6 gives a more detailed analysis of expenses underlining the significant year-on-year increase in compensation and IT-related costs. As noted earlier, these arise from investment to support the sustainability and growth of the business together with costs added following acquisitions (Virtual Investor Conferences and Qaravan). The number of staff increased from 89 at end September last year to 101 this year (+13%), while annual base salary increases were c 6%, reflecting a competitive market, particularly for suitably experienced IT staff. The near 20% increase in IT costs included some non-recurring costs for renewal of equipment in OTCM's primary and secondary data centres, which amounted to \$0.102m in Q3 and \$0.172m for 9M19.

As in the previous four quarters, occupancy costs were ahead of the Q318 level, reflecting costs associated with the new headquarters where both square footage and pro rata rent have increased compared with the old office. The additional space, improved IT infrastructure, and enhanced meeting and media production facilities are already proving beneficial and should facilitate development of the group over time.

The 9M19 occupancy costs include one-off costs related to the move of \$0.26m and, taking this and other one-off items, the group indicates that there was a total of approximately \$0.7m in one-off costs that should not be repeated in 2020.

Exhibit 6: Analysis of operating expenses							
\$000s unless stated	Q318	Q418	Q119	Q219	Q319	y-o-y %	q-o-q %
Compensation and benefits	5,672	6,075	6,996	6,754	6,533	15.2	(3.3)
IT Infrastructure and information services	1,377	1,477	1,527	1,614	1,650	19.8	2.2
Professional and consulting fees	590	519	400	546	489	(17.1)	(10.4)
Marketing and advertising	164	402	251	242	256	56.1	5.8
Occupancy costs	436	750	846	605	569	30.5	(6.0)
<i>Excluding \$0.26m overlapping rent cost</i>			586				
Depreciation and amortization	259	260	279	380	384	48.3	1.1
General, administration and other	247	359	269	293	330	33.6	12.6
Total	8,745	9,842	10,568	10,434	10,211	16.8	(2.1)
<i>Excluding \$0.467m one-off HQ move costs</i>			10,101				
Source: OTCM, Edison Investment Research							

We show selected quarterly **operating metrics** in Exhibit 7.

Within the OTC Link metrics, we note that the number of active OTC Link ATS participants was stable q-o-q at 90 but this compared with 92 for Q318, with the reduction part of a longer-term erosion in the number of broker-dealers on the platform as a result of consolidation and withdrawals under the pressure of tighter margins. Positively, the number of subscribers to the ECN platform has continued to increase, reaching 47 at the end of the quarter.

The main points for Corporate Services are the increase in the number of OTCQX corporate clients and a small reduction for OTCQB. The OTCQX gain reflects a good level of sales and a three percentage point increase in the renewal rate for calendar 2019 to 94%. OTCQB sales were lower in Q319 at 53 versus 76, perhaps reflecting a weaker market trend in venture markets (see next section), while the non-renewal rate and other cancellations were stable.

The Market Data Licensing figures show a modest increase in the number of professional users (they account for roughly half segmental revenue) and a slightly larger percentage decline in the number of non-professional users (a much smaller portion of revenue). As noted above, the increase in compliance data file users and the addition of two broker-dealer licences were more influential in the revenue growth recorded in the third quarter (see Exhibit 5).

Exhibit 7: Operating and related revenue data

	Q318	Q418	Q119	Q219	Q319	% change y-o-y	% change q-o-q
OTC Link							
Number of securities quoted	10,121	10,042	10,091	10,645	10,609	4.8	(0.3)
Number of active ATS participants	92	91	92	90	90	(2.2)	0.0
Number of ECN subscribers	36	41	42	45	47	30.6	4.4
New form 211 filings	113	393	97	86	77	(31.9)	(10.5)
Revenue per security quoted (\$)	277	291	282	272	282	1.6	3.5
Revenue per average active participant (\$)	29,240	31,043	30,245	30,995	33,211	13.6	7.2
Corporate Services							
Number of corporate clients							
OTCQX	395	409	414	421	436	10.4	3.6
OTCQB	953	934	941	916	915	(4.0)	(0.1)
Pink	736	741	740	747	749	1.8	0.3
Total	2,084	2,084	2,095	2,084	2,100	0.8	0.8
Revenue per client (\$)	2,973	3,137	3,075	3,213	3,182	7.0	(1.0)
Graduates to a national securities exchange	16	13	12	13	14	(12.5)	7.7
Market Data Licensing							
Market data professional users	20,991	21,487	21,776	21,766	21,446	2.2	(1.5)
Market data non-professional users	14,661	14,763	14,976	13,991	13,892	(5.2)	(0.7)
Revenue per terminal (total - \$)	162	164	165	170	172	6.5	1.3

Source: OTCM, Edison Investment Research

Strategic alliance with North Capital Investment Technology

In October, OTCM announced a strategic alliance with North Capital Investment Technology. This alliance ties in with the group's positive view on the long-term potential for online private fund-raising and enthusiasm for applying technology to deliver cost-effective solutions for customers that minimise administrative burdens. OTCM cites a 2017 PWC study that found an average cost of \$7.3m to raise between \$25m and \$100m through a public offering, a significant burden for a small venture company. Online private and public fund-raising is a way of reducing such costs and the alliance will allow companies on OTCQX and OTCQB to have access to the North Capital Technology platform to manage the whole process. Revenue sharing arrangements are in place as part of the alliance, which provides OTCM with a ready-made technology solution that can be integrated with its own website.

Regulatory developments

OTCM highlighted two publications from the SEC as being potentially significant for the business: a concept release and request for comment, and a proposed rule change.

The first, the [Concept Release on Harmonization of Securities Offering Exemptions](#), was issued in June and seeks comments on the merits of changes to simplify, harmonize and improve the exempt offering framework. These exemptions have evolved over time with the JOBS, FAST and Economic Growth Acts all contributing to this process, adding complexity but also making a contribution to the growth in exempt offerings, which have outpaced registered offerings for at least the last 10 years (2018: \$2.9tn versus \$1.4tn). OTCM sees an opportunity here for modernisation of secondary market regulation and the exempt offering framework that would facilitate small company capital raising and enhance disclosure requirements for the benefit of investors. Its [comments to the SEC](#) include proposals intended to: (1) support small company capital formation; (2) fix the plumbing of small company public trading markets; and (3) enhance disclosures required from insiders, affiliates and other powerful market participants. Under (2) OTCM suggests consideration of pre-empting state Blue Sky rules with a uniform federal secondary trading exemption where adequate current information is publicly available. [Other comments](#) submitted have reflected different perspectives. These include one from the SEC's own investor advocate that questions the potential for additional retail demand for exempt offerings, the appetite of companies for small retail shareholdings and

how appropriate such investments would be for these investors. Given this is a concept release and no proposals have yet been developed by the SEC, it is too early to suggest how any potential changes might affect the OTCM business.

The second SEC action highlighted was the [Proposed Rule and concept release on Exchange Act Rule 15c2-11](#). The rule concerned governs the publication of quotes in interdealer quotation systems such as the company's OTC Link ATS and the proposed rule would require that information on the issuer and security be current and publicly available before a broker-dealer can begin or continue quoting that security. The SEC points out that securities traded on the OTC market are primarily owned by retail investors and that the absence of current information can contribute to incidents of fraud and manipulation.

OTCM notes that the new rule would recognise its disclosure standards and that certain securities could join its markets without a third party filing a Form 211. Companies without current information, such as those designated Pink No Information by OTCM would be excluded from having public broker-dealer quotes on OTC Link ATS. OTCM is currently preparing its comments on the proposed rule and intends to include reference to:

- market efficiency benefits from regulatory recognition of OTCM's disclosure standards;
- proposals to provide efficient 'expert' markets for professional investors in securities which no longer have public quotes;
- proposed additional regulatory guidance needed to give effect to the rule; and
- potential changes to the FINRA rule relating to complying with the information requirements of Rule 15c2-11.

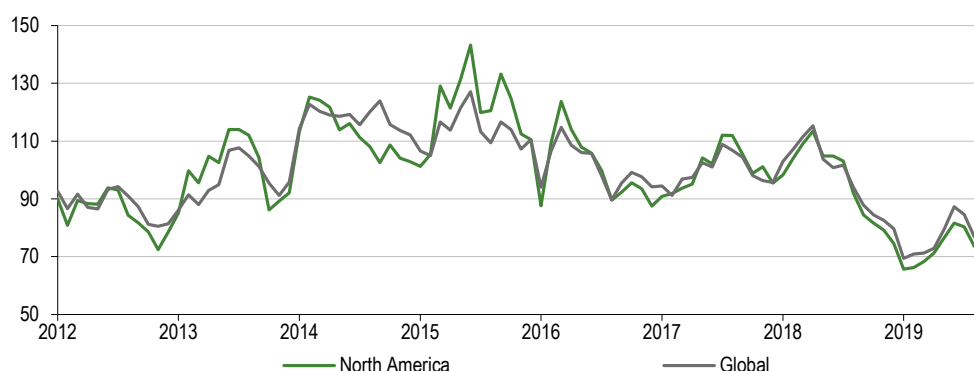
While OTCM indicates that its financial results would be affected (potentially both positively and negatively) if the rule change were adopted as proposed, it cannot determine how material this would be.

Background and outlook

We start by looking at the recent performance of selected equity market indices (Exhibit 8). This shows positive performance for the larger-cap dominated S&P 500 and Nasdaq Composite indices over all periods, with gains of over 25% year to date. The OTCQX Composite has also performed strongly year to date but the venture indices, including OTCQB, have experienced a markedly weaker performance over the periods shown.

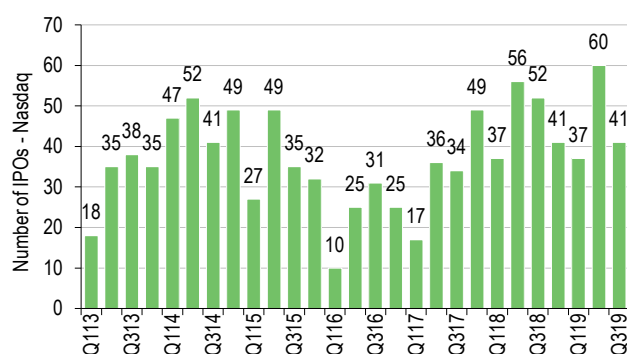
Exhibit 8: Recent market index performance (total return %)						
Period	S&P 500	Nasdaq Composite	OTCQX Composite	OTCQB	S&P TSX Venture	AIM All-Share
	US\$	US\$	US\$	US\$	C\$	£
3 months	8.6	8.6	-2.9	-9.6	-7.9	4.4
6 months	10.2	10.0	1.9	-24.0	-13.7	-6.0
1 year	16.4	19.3	9.9	-21.3	-15.7	-5.3
Year to date	26.8	30.1	19.6	-18.4	-5.6	5.5
Source: Bloomberg. Note: Priced on 18 November 2019.						

The weakness in venture markets can be seen as a result of reduced investor risk appetite and this is captured in the State Street Investor Confidence Index. The index tracks changes in institutional investor holdings of risky versus safer investments and has declined significantly since a recent high in 2015, while showing some recovery from a low point earlier in 2019.

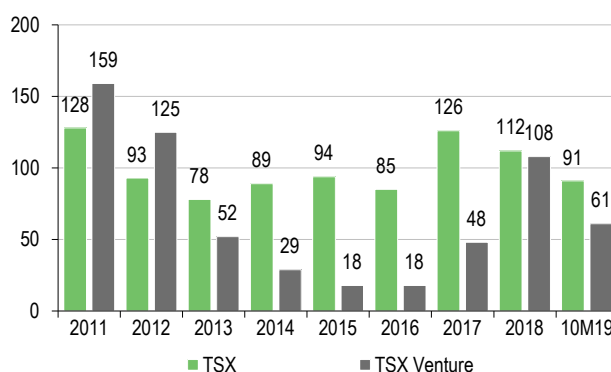
Exhibit 9: State Street Investor Confidence Index


Source: Bloomberg, State Street

Exhibits 10 and 11 show IPO numbers for Nasdaq, and the Canadian TSX and TSX Venture exchanges as indicators of corporate and market confidence and activity. The number of IPOs on Nasdaq in the first nine months of 2019 was 5% below the prior year period at 138, but still 23% above the average nine-monthly rate of 112 over the period shown. On the Canadian exchanges, TSX IPOs in the first 10 months of the year were down 10% while, in tune with the market performance and apparent investor risk aversion, TSX Venture IPOs were 28% below the prior year period. Not shown here, but the number of new admissions to AIM in the first 10 months of 2019 were down 62% at 20, with the weakness likely to have been amplified by Brexit uncertainties.

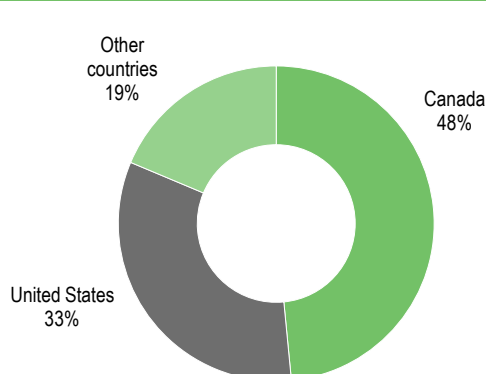
Exhibit 10: Nasdaq – number of IPOs


Source: Nasdaq

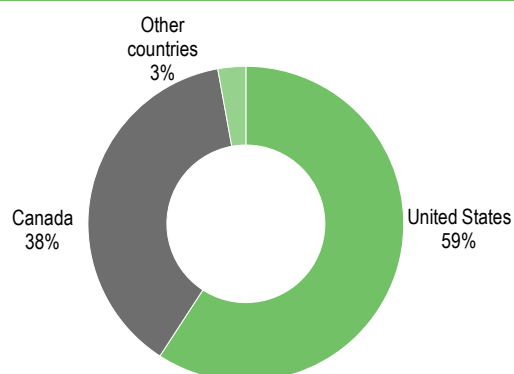
Exhibit 11: TSX and TSX Venture – number of IPOs


Source: TMX

OTCM has highlighted success in winning international clients for its premium markets, with 21 joining OTCQX in the third quarter including large cap names such as Hugo Boss. For international companies, OTCQX and OTCQB markets offer a complementary service to their domestic listing, facilitating cost-effective access to the US investor base. OTC's directed marketing efforts to international companies continue to be helped by its partnership with the Canadian Securities Exchange and its own London office, established at the beginning of the year. In addition to OTCM's traditional strength in Canada, prospective areas include European SMEs, Israeli venture-stage technology companies, and Australian minerals and resources companies. In total, there are already more than 600 international companies across both premium markets. The current geographical make-up of OTCQX and OTCQB Venture indices is shown in Exhibits 12 and 13. International companies account for 67% of OTCQX and 41% of OTCQB Venture indices, with the company seeing substantial potential for further growth in the number of international companies given the very large existing opportunity set and flow of new issues across international stock exchanges.

Exhibit 12: OTCQX Composite Index constituents


Source: OTCM. Note: % of 359 constituents 7/11/19 (484 companies on OTCQX at end September 2019).

Exhibit 13: OTCQB Venture Index constituents


Source: OTCM. Note: % of 702 constituents 7/11/19 (964 companies on OTCQB at end September 2019).

Looking ahead, near-term fluctuations in market sentiment could affect trading activity levels for OTC Link and corporate confidence, and hence the willingness of corporates and institutions to sign up for OTCM's services. However, more strategically, the potential development of online/crowdfunding capital raising could present a major opportunity for the group by generating a larger population of companies for which OTCM's cost-effective markets would be appealing venues for secondary trading. Potential regulatory change could be of assistance here, although the detail of implementation and the market response will be key, and the SEC concept release and rule change discussed earlier remain at a formative stage. In the meantime, OTCM remains focused on its long-term strategy, and its commitment to using technology to provide cost-effective solutions for customers should be a strength as the market background and competitive conditions change over time.

Financials

Exhibit 14 summarises the changes in key numbers in our estimates following the Q319 results, with further detail included in the financial summary in Exhibit 17. Our revenue assumptions are essentially unchanged, with marginal changes in the mix between segments. We increased our operating expense assumptions earlier in the year and, again, changes this time are only marginal resulting in virtually unchanged pre-tax profit and EPS estimates for FY19 and FY20. Our dividend assumption for the current year is adjusted for the unchanged special dividend announced with the results, which was slightly lower than we factored in previously.

Exhibit 14: Estimate revisions

	Gross revenue (\$m)			PBT (\$m)			Fully diluted EPS (\$)			Dividend (\$)		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
2019e	62.8	62.8	0.0	18.2	18.1	-0.5	1.25	1.26	0.5	1.27	1.25	-1.6
2020e	66.6	66.6	0.0	21.0	21.0	0.0	1.43	1.42	-0.2	1.33	1.33	0.0

Source: Edison Investment Research. Note: Dividends include special dividends of 65c (actual) and 73c for FY19 and FY20, respectively.

The balance sheet remains strong, with cash of \$25.8m and no debt at the end of Q319 (\$26.1m end Q318) or \$27.4m including restricted cash. 9M19 cash flow shows a jump in spending within investing activities at \$5.35m versus \$0.34m, reflecting the cash element of the Qaravan acquisition and spending associated with the headquarters move in Q1 and datacentre upgrades (completed ahead of plan in Q3). Excluding further acquisition opportunities, we expect investment spending to revert to a lower level, with a figure of \$1.3m assumed in our estimate for FY20, for example.

Valuation

We have updated our comparative P/E table in Exhibit 15, which includes information providers MSCI and Markit together with the average multiples for global exchanges. OTCM shares are trading on prospective P/Es just below the average for exchanges and noticeably below those for information providers.

Exhibit 15: OTCM comparative multiples		
	P/E ratios (x)	
	2019e	2020e
MSCI	39.6	35.1
Markit	27.3	24.6
Average information providers	33.5	29.9
Average global exchanges	28.4	25.0
OTCM	27.0	23.9

Source: Refinitiv, Edison Investment Research. Note: Prices as at 18 November 2019.

The sensitivity of our discounted cash flow valuation to different discount rate and long-term growth assumptions is shown in the next table. The model factors in our explicit forecasts for FY19/20, which are essentially unchanged, together with an assumption of FY21–22 cash flow growth of 5%, long-term growth of 4% and a terminal cash flow multiple of c 21x, compared with the current year value of 26x. Our fair value is unchanged at \$37.00 per share.

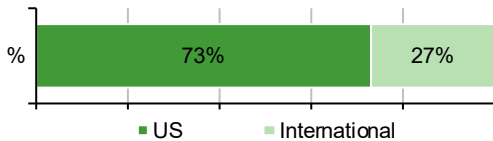
Exhibit 16: Discounted cash flow valuation sensitivity (\$ per share)					
Discount rate (right)	8%	9%	10%	11%	12%
2023–29e growth					
3%	40.6	37.8	35.3	33.1	31.0
4%	42.5	39.6	37.0	34.6	32.4
5%	44.6	41.5	38.7	36.2	33.9
6%	46.8	43.5	40.6	37.9	35.4

Source: Edison Investment Research

Exhibit 17: Financial summary

\$000s	2015	2016	2017	2018	2019e	2020e
Year end 31 December						
PROFIT & LOSS						
OTC Link	11,796	10,573	10,074	11,175	11,730	12,258
Market Data Licensing	20,610	21,054	21,922	23,384	24,403	25,867
Corporate Services	17,503	19,254	22,660	24,719	26,619	28,482
Revenue	49,909	50,881	54,656	59,278	62,752	66,607
Re-distribution fees and rebates	(2,379)	(2,317)	(2,480)	(2,448)	(2,482)	(2,561)
Net revenue	47,530	48,564	52,176	56,830	60,270	64,047
Transaction-based expenses	0	0	0	(375)	(750)	(826)
Revenues less transaction-based expenses	47,530	48,564	52,176	56,455	59,520	63,221
Operating expenses	(28,972)	(30,032)	(32,511)	(35,768)	(40,071)	(40,779)
EBITDA	18,558	18,532	19,665	20,687	19,449	22,442
Depreciation	(1,692)	(1,606)	(1,361)	(1,042)	(1,427)	(1,540)
Operating profit	16,866	16,926	18,304	19,645	18,022	20,902
Net interest	27	9	47	116	112	110
Profit Before Tax	16,893	16,935	18,351	19,761	18,134	21,012
Tax	(6,635)	(6,407)	(5,792)	(3,524)	(3,051)	(3,992)
Profit after tax	10,258	10,528	12,559	16,237	15,083	17,019
Profit after tax and allocation to RSAs	9,971	10,252	12,241	15,840	14,716	16,652
Average Number of Shares Outstanding (m)	11.3	11.3	11.6	11.6	11.7	11.7
EPS - basic (c)	90.6	92.4	109.9	140.8	129.6	146.6
Fully diluted EPS (c)	88.3	90.4	105.8	136.3	125.9	142.3
Dividend per share (c)	108.0	116.0	116.0	123.0	125.0	133.0
EBITDA Margin (%)	39	38	38	36	32	35
Operating profit margin (%)	35	35	35	35	30	33
BALANCE SHEET						
Non-current assets						
Intangible assets	291	291	362	312	283	329
Property and other	4,187	3,267	3,506	4,584	24,853	24,567
Current assets						
Debtors	6,082	6,262	6,450	4,942	4,752	4,752
Cash & cash investments	23,925	25,034	23,683	28,813	26,751	32,185
Other current assets	1,729	1,789	2,316	2,998	2,907	2,907
Current liabilities						
Deferred revenues	(12,737)	(14,664)	(15,531)	(16,070)	(17,505)	(18,731)
Other current liabilities	(5,063)	(5,372)	(5,644)	(6,711)	(6,609)	(6,609)
Long-term liabilities						
Tax, rent and other	(867)	(1,101)	(1,351)	(2,459)	(17,539)	(17,539)
Net assets	17,547	15,506	13,791	16,409	17,893	21,861
NAV per share (\$)	1.55	1.36	1.21	1.42	1.54	1.88
CASH FLOW						
Operating cash flow	22,400	21,752	21,629	24,442	22,840	26,117
Net Interest	27	9	47	116	112	110
Tax	(5,320)	(6,021)	(5,193)	(1,968)	(2,896)	(3,992)
Capex / intangible investment	(940)	(415)	(1,165)	(549)	(5,730)	(1,300)
Financing / investments	(420)	(1,157)	(3,407)	(2,716)	(1,828)	0
Dividends	(12,094)	(13,059)	(13,262)	(14,195)	(14,560)	(15,501)
Net cash flow	3,653	1,109	(1,351)	5,130	(2,062)	5,434
Opening net (debt)/cash	20,272	23,925	25,034	23,683	28,813	26,751
Closing net (debt)/cash	23,925	25,034	23,683	28,813	26,751	32,185
Cash and restricted cash	24,135	25,244	24,375	30,534	28,311	33,745

Source: OTC Markets Group accounts, Edison Investment Research

Contact details 300 Vesey Street 12th Floor New York, NY 10282 Country (212) 896-4400 www.otcmarkets.com	Revenue by geography  <p>■ US ■ International</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) Ordonez 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 Including R Cromwell Coulson T Rowe Price Horizon Kinetics	(%) 37.8 30.2 4.4 1.1
Companies named in this report MSCI, Markit, Nasdaq	

General disclaimer and copyright

This report has been commissioned by OTC Markets Group and prepared and issued by Edison, in consideration of a fee payable by OTC Markets Group. Edison Investment Research standard fees are £49,500 pa for the production and broad dissemination of a detailed note (Outlook) following by regular (typically quarterly) update notes. Fees are paid upfront in cash without recourse. Edison may seek additional fees for the provision of roadshows and related IR services for the client but does not get remunerated for any investment banking services. We never take payment in stock, options or warrants for any of our services.

Accuracy of content: All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report and have not sought for this information to be independently verified. Opinions contained in this report represent those of the research department of Edison at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations.

Exclusion of Liability: To the fullest extent allowed by law, Edison shall not be liable for any direct, indirect or consequential losses, loss of profits, damages, costs or expenses incurred or suffered by you arising out of or in connection with the access to, use of or reliance on any information contained on this note.

No personalised advice: The information that we provide should not be construed in any manner whatsoever as, personalised advice. Also, the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.

Investment in securities mentioned: Edison has a restrictive policy relating to personal dealing and conflicts of interest. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report, subject to Edison's policies on personal dealing and conflicts of interest.

Copyright: Copyright 2019 Edison Investment Research Limited (Edison). All rights reserved FTSE International Limited ("FTSE") © FTSE 2019. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.

Australia

Edison Investment Research Pty Ltd (Edison AU) is the Australian subsidiary of Edison. Edison AU is a Corporate Authorised Representative (1252501) of Crown Wealth Group Pty Ltd who holds an Australian Financial Services Licence (Number: 494274). This research is issued in Australia by Edison AU and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. Any advice given by Edison AU is general advice only and does not take into account your personal circumstances, needs or objectives. You should, before acting on this advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Product Disclosure Statement or like instrument.

New Zealand

The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (i.e. without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision.

United Kingdom

This document is prepared and provided by Edison for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This Communication is being distributed in the United Kingdom and is directed only at (i) persons having professional experience in matters relating to investments, i.e. investment professionals within the meaning of Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "FPO") (ii) high net-worth companies, unincorporated associations or other bodies within the meaning of Article 49 of the FPO and (iii) persons to whom it is otherwise lawful to distribute it. The investment or investment activity to which this document relates is available only to such persons. It is not intended that this document be distributed or passed on, directly or indirectly, to any other class of persons and in any event and under no circumstances should persons of any other description rely on or act upon the contents of this document.

This Communication is being supplied to you solely for your information and may not be reproduced by, further distributed to or published in whole or in part by, any other person.

United States

Edison relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. This report is a bona fide publication of general and regular circulation offering impersonal investment-related advice, not tailored to a specific investment portfolio or the needs of current and/or prospective subscribers. As such, Edison does not offer or provide personal advice and the research provided is for informational purposes only. No mention of a particular security in this report constitutes a recommendation to buy, sell or hold that or any security, or that any particular security, portfolio of securities, transaction or investment strategy is suitable for any specific person.

Frankfurt +49 (0)69 78 806 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1,185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia