

**Multi Commodity Exchange of India Ltd. - IPO Note: "SUBSCRIBE"**

**22<sup>nd</sup> February, 2012**

*Multi Commodity Exchange of India Ltd (MCX) is a state-of-the-art electronic commodity futures exchange. The Exchange has permanent recognition from the Government of India to facilitate online trading, clearing and settlement operations for commodity futures across the country. MCX currently offers 49 commodities across various segments such as bullion, ferrous & non-ferrous metals, energy and a number of agri-commodities on its platform. As of December 31, 2011, MCX has 2,153 members nationwide, with more than 296,000 terminals operating over 1,572 cities in India. The Exchange's rigorous efforts in introducing new products, expanding to new geographical locations and enhancing investor awareness & Education would enable it to continue growing its turnover at a brisk pace in the future.*

*At the upper band of the issue price, MCX is valued at 18x - 9MFY12 Annualized EPS/share of Rs. 57.8/-. There are no listed companies in India that are engaged in a business similar to MCX. Compared with global players, the valuation also seems reasonable. With due consideration to factors like a) MCX's leadership position in the Indian commodity futures market over the past five years, commanding 87% market share in terms of value of commodity futures contracts traded. b) it being the largest silver exchange, the second largest gold, copper and natural gas exchange and the third largest crude oil exchange as compared to global and domestic peers. c) strong technology-backed trading platform and infrastructure (supplied by its promoter Financial Technologies India Ltd), MCX is able to provide high liquidity and low impact cost of transactions - key criteria for the success of any exchange. d) wide range of strategic alliances including NBHC-which is a national warehousing and supply chain company, Dall & Besan Millers Association, the Solvent Extractors' Association and the Bombay Metal Exchange in the domestic market and the LME, NYMEX, etc in the international markets. These alliances facilitate the sharing of information across regional and global exchanges, enabling MCX to penetrate new markets, enhance product offerings and increase market presence, we believe the stock deserves premium valuations and recommend investors to "SUBSCRIBE" the issue.*

**Financial summary (Consolidated)**

Y/e 31 Mar (Rs. cr)	9MFY12	FY11	FY10	FY09
Total income	474.5	447.6	493.7	365.8
PBIDT	333	270	348	230
PBIDT (%)	70.1	60.4	70.5	62.8
PBT	312	246	323	210
Reported PAT	221	174	221	158
PAT margin (%)	46.5	38.7	44.7	43.0
Equity Capital	50.9	50.9	40.8	40.8
Reserves	1,023	798	656	453
Networth	1,074	849	696.8	493.8

Source: RHP, Ajcon Research

Issue date	Feb 22 – Feb 24, 2012
Issue size	Rs. 6.6 bn at upper end of the price band
FV	Rs.10
Price Band	Rs. 860 -1,032 per share
Issue structure	48.1% - QIBs 14.4% - HNI 33.6% -Retail 3.9% - Employee Reservation
Type of issue	100% Offer for sale - 6.4 mn shares (12.6% of post issue equity)
Equity shares prior to issue	50.9 mn
Equity shares post issue	50.9 mn
Post issue market capitalization	Rs. 52.6 bn at upper price band
Book Running Lead Managers	Edelweiss Financial Services, Citigroup Global Markets and Morgan Stanley.
IPO Grading	Grade 5/5 by CRISIL indicating good fundamentals
Registrar to the issue	Karvy Computershare Pvt. Ltd.
Shareholding Pattern (%)	<b>Post Issue</b>
Promoters	26
Foreign Bodies	23
Institutions	28
Corporates	6
Public	17
<b>Total</b>	<b>100</b>

## Objects of the issue

The issue is a pure offer for sale. Hence, the Company would not receive any proceeds from the Offer. The main object of the issue is to get listed on the exchange.

## ABOUT THE PROMOTERS

MCX is promoted by Financial Technologies (India) Ltd. (FTIL) with a pre-IPO stake of 31.18%. FTIL is a software developer and a technical service provider of automated electronic solutions in the areas of finance and technology like foreign exchange, commodities, and equities. It is listed on the BSE, the NSE, the Ahmedabad Stock Exchange and the Madras Stock Exchange. The promoters of FTIL are Mr Jignesh Shah (18.1%), Mr Dewang Neralla (0.13%) and La-Fin Financial Services Private Ltd (26.5%).

MCX's other larger shareholders include financial institutions and other entities from the financial sector, such as FID Funds (Mauritius) Limited (an affiliate of Fidelity International), Euronext N.V. (an affiliate of NYSE Euronext) and Merrill Lynch Holdings (Mauritius).

## GROUP COMPANIES AND ALLIANCES

On November 9, 2004, MCX signed a memorandum of understanding with Financial Technologies (India) Limited and the Dubai Metals and Commodities Centre (now known as Dubai Multi Commodity Centre) to establish, as a joint venture, the DGCX. DGCX commenced operations with gold futures trading in November 2005. MCX currently hold 5.0% of the equity share capital of DGCX and the book value of this investment was Rs 21.85 million as of December 31, 2011.

MCX CCL is 100% subsidiary which was established as a separate clearing house to undertake clearing and settlement of trades and the provision of counterparty risk guarantee on Exchange. MCX CCL has not commenced operations as it is awaiting the approval of FMC.

MCX-SX was promoted by MCX and its Promoter, FTIL in 2008. However, currently, FTIL does not hold a controlling shareholding in MCX-SX. MCX has reduced its shareholding to 5.0% in MCX-SX pursuant to the Scheme.

Clearing and settlement functions of MCX-SX are performed by MCX-SX Clearing Corporation Limited (MCXSX CCL). MCX-SX CCL was established to undertake clearing and settlement of trades in multi-asset securities. MCX-SX CCL is the second clearing corporation in India handling clearing and settlement of trades done on stock exchanges pursuant to permission granted by SEBI. As of December 31, 2011, MCX had a direct stake of 26.0% in MCX-SX CCL.

SME was incorporated as a subsidiary of MCX on September 14, 2010. SME intends to operate as a stock exchange to enable its members to transact, clear and settle trades in the small and medium enterprises equity and derivative segments. MCX has undertaken to subscribe to 51% of the shareholding in SME and received approval from FMC for an initial investment of Rs 510,000.

## KEY POSITIVES

### *Leadership Position in the Commodity Futures Industry*

MCX is the leading commodity futures exchange in India in terms of value of commodity futures contracts traded in the metals, energy and certain agricultural commodities. According to data maintained by FMC, the total value of commodity futures contracts traded on the Exchange for the nine months ended December 31, 2010 and the fiscal 2010 constituted 83.3% and 82.3%, respectively, of the Indian commodity futures industry during those periods. Among the national commodities exchanges in India, its market share based on the total value of commodities

traded in futures markets for the nine months ended December 31, 2010 for gold, crude oil, silver, copper and natural gas futures contracts was approximately 92.6%, 89.5%, 95.7%, 91.9% and 99.8%, respectively. (Source: Information derived from FMC April – December 2010 data). It is the sixth largest commodity futures exchange globally in terms of the number of contracts traded and were among the leading commodity exchanges in the world in terms of trading volumes of certain commodities. Based on the comparison of the trading volumes of MCX with the leading global commodity futures exchanges in the world, for the calendar year 2010, it was the largest silver exchange, the second largest gold, copper and natural gas exchange and the third largest crude oil exchange for this period.

### **Product and Service Innovation**

The company's strength lies in its ability to introduce new and innovative products, i.e. commodity futures contracts, and services on its Exchange. It was the first exchange in India to offer futures trading in steel, crude oil, and almond. In June 2005, it launched MCXCOMDEX, India's first real time composite commodity futures index, which provides its members with valuable information regarding market movements in the key commodities, as determined by physical market size in India, which are actively traded on its Exchange. It has introduced several other indices, including MCXAgri (agricultural commodities index), MCXEnergy (energy commodities index) and MCXMetal (metal commodities index). It also has three rain indices, namely RAINDEXMUM (Mumbai), RAINDEXIDR (Indore), and RAINDEXJAI (Jaipur) which track the progress of monsoon rains in their respective geographic locations. It was the first exchange in India to initiate evening sessions to synchronize with the trading hours of global exchanges in London, New York and other major international markets. In addition, it provides its members with real time market information regarding prices and trading activity, which may help refine investment decisions. In December 2009, it launched EFP transactions for the first time in India, which enables parties with futures positions to swap their positions in the physical markets and *vice versa*. In October 2009, it teamed up with a third party to jointly release the "Commodity Insights Yearbook 2009", which is a first of its kind publication in India on commodities. In December 2010, it launched the second edition of this yearbook. It undertook these publications with the aim of giving readers insights into the Indian commodity market ecosystem. In May 2010 and June 2010, MCX launched its zinc mini futures and lead mini futures contracts, which offer trading in these metals in smaller lot sizes. In January 2011, it launched iron ore futures contracts, which are designed to be a benchmark for the Indian iron ore fines export market, and, in February 2011, we launched silver micro and aluminium mini contracts, which offer trading in these metals in smaller lot sizes.

### **Technology Infrastructure**

Technology infrastructure is the foundation of its business and a key factor in its development. Its online trading platform is accessible to its members through its trader workstation or computer-to computer link ("CTCL") using multiple media of connectivity including VSATs, VPN, leased lines, mobiles and the internet. The electronic platform is supported by our infrastructure and advanced technology, allowing faster trade execution, anonymity, price transparency, prompt and reliable order routing, trade reporting, market data dissemination and market surveillance. The system tracks its members' margin utilizations and tracks mark-to-market ("MTM") losses online against their deposit available with Exchange and automatically generates alerts and takes pre-decided actions. The company's electronic trading platform is supplied by its Promoter, FTIL, which is one of the leading technology companies in the development and deployment of exchange related software and technology in India. We believe that technology for the exchange industry is difficult to replicate, thus providing the company with a competitive advantage. Further, it operates in an environment which requires constant technology upgrades or variations and support due to changes required by the regulatory regime and market forces. The technical expertise and experience of FTIL enables to obtain speedy and efficient technology solutions, such as customisation and development of new software for new products and services.

### **Scalable Technology Platform and Business Model**

The company's technology platform and business model are highly scalable and have the potential to generate better margins at greater volumes. The company plans for and structures its business costs based on its historical and

expected growth. Consequently, the company made significant investments in developing its fixed operating infrastructure, including the technology systems, to support its anticipated growth and increase in the demand for the products. The company believes that the current technology infrastructure is sufficient to handle daily trading volumes of up to 10,000,000 trades a day, which is more than ten times our present daily record high of 935,335 trades. Increased trading activity on the Exchange would result in increased profitability. Further, it intends to increase the use of data generated from the commodity futures contracts traded on the Exchange to capitalise on the opportunities in market data products and information dissemination.

### ***Strong earnings growth***

MCX's sources of operating income are transaction fees, membership admission fees, annual subscription fees and terminal charges. MCX's operating revenue has grown at a CAGR of 32% over FY09-11, with major growth coming through transaction fees, which grew at a CAGR of 37% over the same period. EBITDA margin improved to 70.1% in 9MFY12 from 53.6% in FY09, on account of operating leverage – most of MCX's operating costs are fixed and semi-fixed in nature. Return on equity decreased marginally from 24.4% in FY09 to 22.8% in FY11.

### ***Integrated Infrastructure and Network of Alliances***

The operation of business is supported by the exchange related support infrastructure that it has developed and its network of strategic alliances, which helps it to grow its business and expand its market presence. This includes its Group Company, NBHC, which is a national warehousing and supply Chain Company that provides warehouse and collateral management services and implements quality systems for receipt, storage, fumigation, product classification, weight certification, as well as outloading services for commodities.

The company believes that this relationship provides it with synergies arising from the physical settlement of commodity futures contracts traded on its Exchange. In addition, it has formed strategic alliances in India with a diverse range of business associations, such as the Dall & Besan Millers Association, the Solvent Extractors' Association, an industry association for pulses and the Bombay Metal Exchange. Among international alliances, it has formed strategic alliances with a number of exchanges such as the London Metal Exchange, the New York Mercantile Exchange, the LIFFE Administration and Management, the Baltic Exchange Limited, Shanghai Futures Exchange and Taiwan Futures Exchange. These alliances facilitate the sharing of information across regional and global exchanges, enabling it to penetrate new markets, enhance its product offerings and increase its market presence.

### **KEY CONCERNS**

- 1) The company has made investments in the form of equity share capital and warrants in MCX-SX. In the event of an adverse outcome in the outstanding litigation between MCX-SX and SEBI in relation to the application for diversification of trading operations, it may not be able to benefit from the investments as anticipated.
- 2) The commodities trading industry has been and continues to be subject to strict regulatory requirements and scrutiny. MCX face the risk of changes in laws, regulations or governmental policies or taxation which may diminish the trading volumes or have an adverse effect on the way the commodity futures exchanges conduct their business. Further, new legislation, regulations or enforcement may require MCX to allocate more resources to regulatory compliance and oversight, impede its ability to operate and grow business, which would adversely affect the business, financial condition and results of operations.

For research related queries contact Mr. Akash Jain, AVP - Research at [research@ajcon.net](mailto:research@ajcon.net)

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