

BSE SENSEX

33,371

S&P CNX

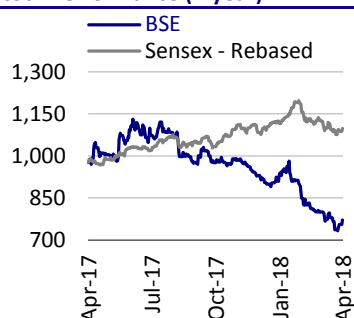
10,245


Stock Info

Bloomberg	BSE IN
Equity Shares (m)	54.8
52-Week Range (INR)	1178 / 726
1, 6, 12 Rel. Per (%)	-1/-27/-33
M.Cap. (INR b)	57.2
M.Cap. (USD b)	0.9
Avg Val, INRm	167.0
Free float (%)	100.0

Financials Snapshot (INR b)

Y/E Mar	FY18E	FY19E	FY20E
Net Sales	4.7	5.1	5.5
EBITDA	1.1	1.2	1.4
PAT	2.3	2.6	2.8
EPS (INR)	41.9	46.8	52.0
EPS Gr (%)	2.2	11.7	11.2
BV / Sh (INR)	492	617	628
P/E (x)	6.1	16.9	15.2
P / BV (x)	1.6	1.3	1.3
RoE (%)	8.5	7.6	8.3
RoCE (%)	11.1	9.9	10.5

Stock Performance (1-year)

CMP: INR788
TP: INR1,070(+36%)
Upgrade to Buy
Going anti-tide, pro-value
Upgrading to Buy

- BSE has started charging 32 of the 37 asset management companies (AMCs) for services through its mutual fund (MF) platform. This could be an INR150m-200m revenue opportunity in the next fiscal; however, being the first year, we are currently modeling INR100m revenues from the segment.
- With ~50% of equity transaction revenues from exclusive segments, dependence on equity transactions where BSE is a distant second to NSE, is <15%. BSE cited that volumes in the exclusively-listed segment are inelastic to transaction charges, and hence, it does not feel the need to reduce the current fee.
- We note that BSE should be paying out 85%+ of its non-exceptional profits as dividends. And any buybacks like the one currently underway will be over and above the dividends. The combination will keep yields attractive (currently ~5%).
- Apart from the boost of Star MF monetization, and lowering risk from bridging equities gap to NSE, we see option value in BSE from multiple potential triggers: [1] monetization of INX, where volume ramp-up continues, [2] interoperability of clearing corporations – while this brings down overall margin requirements for traders, it could still benefit the challenging exchanges and hurt exchanges with monopolistic market share, and [3] new / smaller segments such as commodity derivatives, currency derivatives, bond issuance platform, interest rate derivatives, SME platform.
- We value BSE on a SOTP basis, ascribing value to [1] core operations ex-cash income (INR369/share), [2] implied value from CDSL's market price @20% holding company discount (INR110/share), [3] owned unencumbered cash (INR293/share), and [4] float income from encumbered / margin money (INR300/share). Our target price of INR1,070 implies 36% upside. Upgrade to Buy.

Monetization of the Star MF platform underway

- Towards the end of February, BSE disclosed that 26 asset management companies (AMCs) agreed to pay fees to the bourse for the services being provided through its mutual fund (MF) platform. Around a week later, another six AMCs agreed to pay for the services, taking the total tally to 32. It cited that the remaining five are expected to follow the path soon. BSE's market share in the Star MF platform stands at 76% based on the value of purchase / redemption orders executed.
- Total MF turnover on its platform was up 63% YoY for 9MFY18 to INR788b through 10.7m orders. With continued growth in the segment, at our estimated average realization of INR5 per order, this can contribute INR150m-100m revenues next fiscal. We are currently modeling ~INR100m for FY19

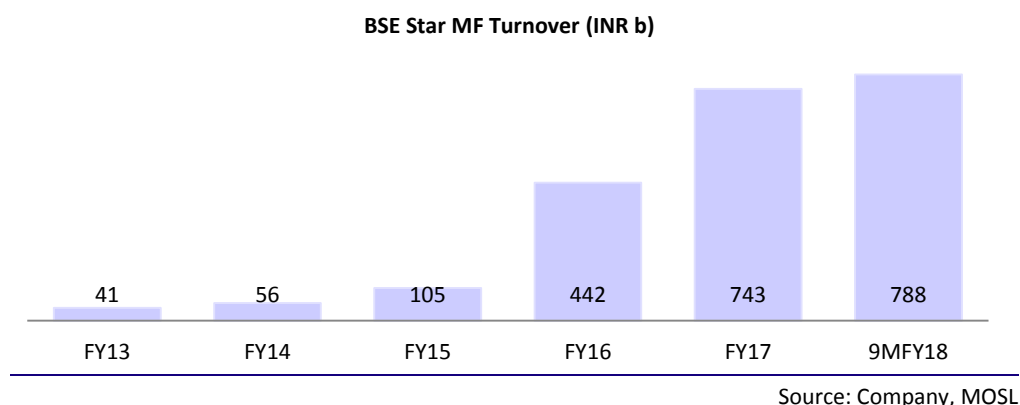
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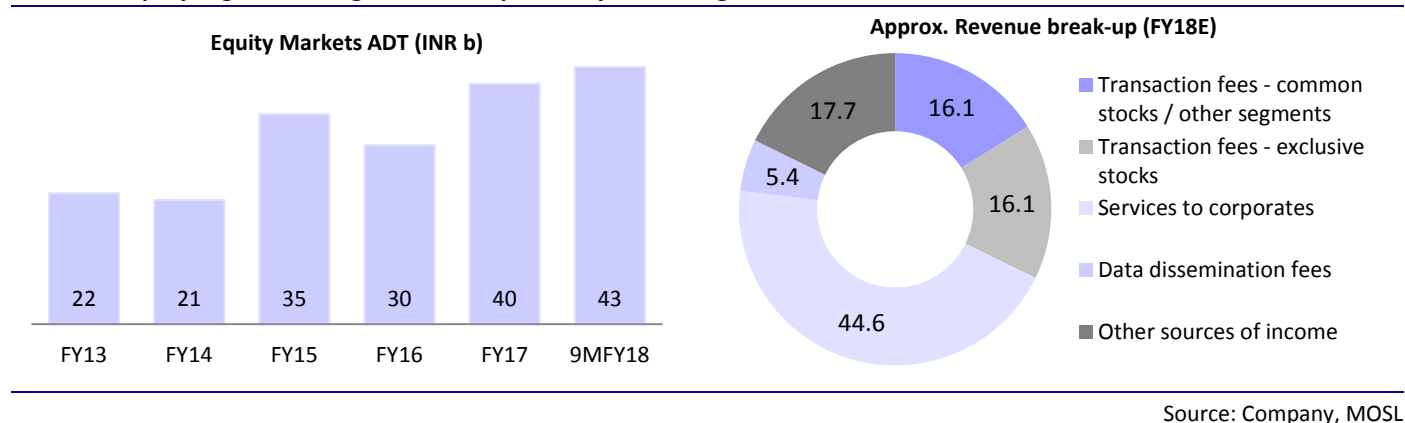
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Exhibit 1: Healthy volume base to monetize the mutual fund platform**Reduced dependency on lagging area of equities**

- BSE's initiatives to recoup market share in the equities segment have experienced little success, with NSE dominating the cash (86% share) and equity derivatives (~94% share) segments.
- However, BSE's dependence on revenues from this segment continues to recede, as contributions from other segments grow. In 9MFY18, of the total operating income of INR3,508m (excluding income from cash / treasury operations), transaction charges on equities stood at INR1,035m.
- Approximately half of this would be from exclusive group of stocks where transactions are charged at the rate of 0.1% of value. So, effectively, the income from securities where it competes head-on with NSE is <15%, and is only a marginal determinant of BSE's earnings potential.

Exhibit 2: Equity segment faring well, but dependency on the segment is lower**Cognizance of shareholder value reflected in treatment of cash**

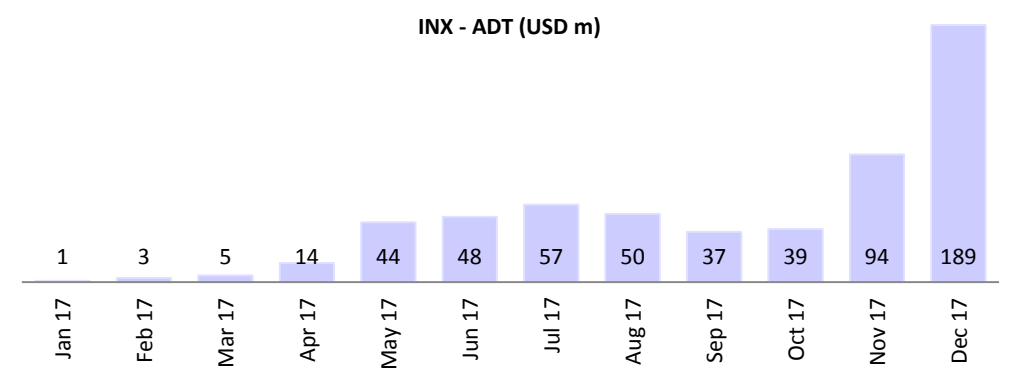
- BSE is expected to pay a majority of its profits (we expect 85% before exceptional items) as dividend. That would imply an attractive yield of ~5% at current levels.
- The current ongoing buyback of ~INR1.6b is over and above the same, adding further to shareholder returns.
- Even after adjusting for the additional investments that INX will need, BSE will still be left with INR10b-11b of free unencumbered cash. We believe that the excess cash will continue to be prudently disbursed to the shareholders from time to time, further increasing the attraction of stock yields at current levels.

Three option values in the stock

We believe there are three potential option values, which could provide further impetus to BSE's financials, which currently are not captured in our estimates:

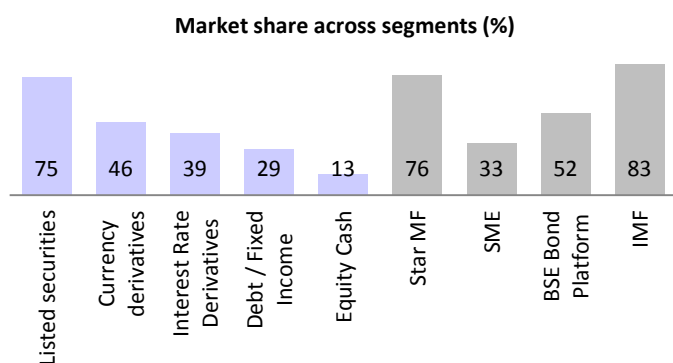
1. **Monetization of INX:** Current trading levels of ~10k contracts a day may not make a case for significant movement of the revenue needle from this segment. Hence, BSE continues with its zero transaction charges on INX for now. However, trading in Gold and Index derivatives has been picking up sharply over the months, due to which we will continue to keep a watch on the same.

Exhibit 3: ADT in INX has witnessed continuous uptick thus far, though BSE is not charging yet

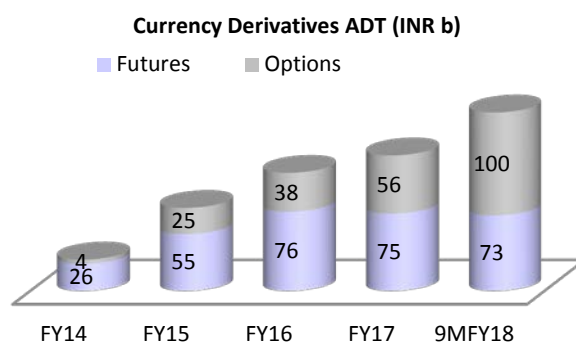


Source: Company, MOSL

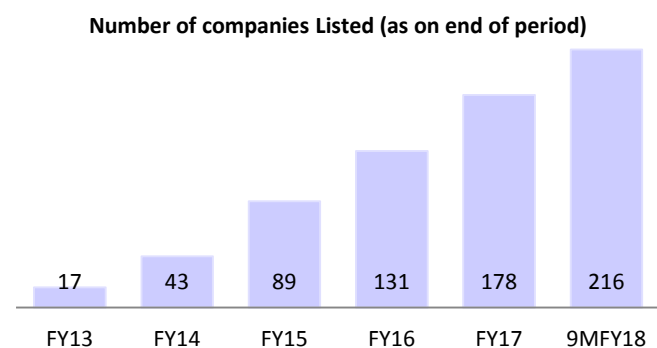
2. **Interoperability of clearing corporation:** SEBI has for some time now, been weighing interoperability of clearing houses and lower margin requirements in an attempt to reduce trading costs and minimize the impact of trading halts ([Link](#)). The market regulator has been weighing the idea for several years and has lately revived discussions to help soften some of the impact from the return of LTCG tax. **With inter-operability, a trader can settle his trades at any clearing house by paying margins and collateral at only one.** The development would be a positive for BSE, as by injecting more competition, it will eliminate the monopolizing network effect found in exchanges and clearing corporations.
3. **Commodity derivatives among other new / smaller segments:** Towards the end of the calendar year, BSE and NSE will be allowed to launch commodity derivatives as well, implying competition for MCX and NCDEX. This could add to the profit pool for BSE over the medium-to-long term. However, this will be challenging, considering that there is still some way to go before BSE qualifies for commodity options. Also, SEBI, in its recent circular, curbed the liquidity enhancement schemes (LES) in commodity derivatives, limiting these only to illiquid contracts. Other segments that are currently new / smaller in scale and hold similar potential are currency derivatives, bond issuance platform, interest rate derivatives, SME platform.

Exhibit 4: Market share apart from equities is respectable

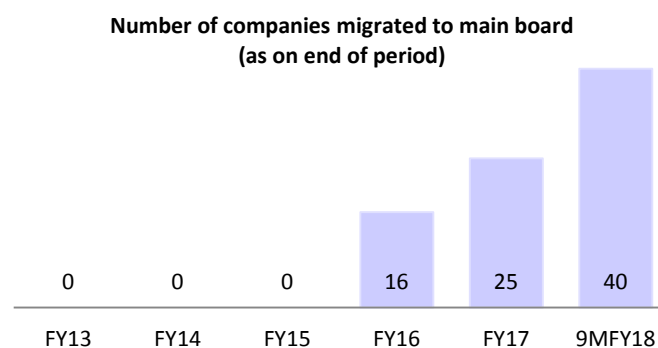
Source: Company, MOSL

Exhibit 5: Continued growth in currency derivatives segment

Source: Company, MOSL

Exhibit 6: Number of companies on SME platform has been growing

Source: Company, MOSL

Exhibit 7: 40 companies on SME platform have migrated to main Board

Source: Company, MOSL

Upgrade to Buy on attractive risk-reward

- We look at the investment prospects of BSE, dividing it into four components: [1] core operations, [2] its stake in CDSL, [3] own cash, [4] cash that is margin money from members.
 1. Given the continued stream of revenues from exclusive listings, annuity income from listed securities and additional income from star MF platform going forward, we expect core earnings to grow from INR8 per share in FY18 to INR12.3 per share in FY20. We value this at 30x, considering significant ROI and limited competition, with only a small component (<15%) competing sluggishly with NSE. We also note that rich multiples are ascribed to exchanges, including on cash income, which we have excluded in the earnings above.
 2. We value the owned cash that is unencumbered at 1x, or INR16b, which contributes INR293 per share to our SOTP.
 3. Margin money is volatile, subject to the volumes on the exchange, and discretion on choice of instruments for investing them is limited. Total cash on BSE's books as on FY17 was over INR45b. However, the remainder (over and above the INR16b) was contributed from variety of factors – either member deposits, or parked towards net worth requirements of clearing corporation and INX, which cannot be distributed. Such cash cannot find its way directly to the shareholders, though it will continue to contribute to the other income. Hence, we adopt a conservative approach in valuing the same

– on 80% of the base – the annuity value for a 5% yield. This amounts to INR300 per share.

4. We value BSE's share in CDSL with a 20% holding company discount, which implies contribution of INR105/share to our target price.
- The SOTP price for BSE thus arrived is INR1,070, an upside of 36% to the CMP. We upgrade our rating on BSE to BUY. Risks to our thesis are any drop in the transaction charges for exclusive segment, and adverse market developments adversely affecting the volumes of smaller stocks.

Exhibit 8: Total cash on FY17 books, and some details on cash belonging to members

BSE Cash and Equivalents	FY15	FY16	FY17
Other investments	14,239	15,429	14,916
Other Financial Assets	1,483	3,315	2,536
Total non-current cash investments	15,722	18,744	17,452
Current Investments	8,773	5,705	5,020
Cash and equivalents	3,363	3,363	11,637
Bank balances	9,594	9,631	12,621
Other financial assets	709	748	563
Total current	22,439	19,445	29,840
Total Cash & Equivalents	38,161	38,189	47,293
Other Financial liabilities	11,061	10,859	16,710
Deposits from trading members	906	906	940
Deposits from clearing banks	1,380	1,380	1,428
Deposit and margin from members	2,116	1,816	5,156
Settlement obligations payable	3,036	2,970	5,025
Other deposits from members	490	516	303
Other deposits from members	294	79	317
Companies - 1% of public issue	1,333	1,433	1,341
Defaulters liabilities	684	670	280
Withheld liabilities	394	568	590

Source: Company, MOSL

Financials and Valuations

Income Statement								(INR M)
Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Revenue	3,173.1	3,115.5	4,021.8	4,686.2	5,223.0	4,673.0	5,057.8	5,482.7
Revenue ex-CDSL	2,268.1	2,244.5	2,975.8	3,459.2	3,765.0	4,673.0	5,057.8	5,482.7
Change (%)	-13.0	-1.0	32.6	16.2	8.8	24.1	8.2	8.4
Employee expenses	772.4	853.7	998.7	1,115.5	1,415.0	1,196.0	1,279.7	1,369.3
Technology expenses	717.3	642.1	704.2	806.4	1,056.0	1,148.0	1,239.8	1,339.0
Admin & Others	931.0	927.9	1,491.5	1,655.7	1,732.0	1,274.0	1,315.8	1,359.6
EBITDA	752.4	691.8	827.4	1,108.6	1,020.0	1,055.0	1,222.4	1,414.8
EBITDA %	23.7	22.2	20.6	23.7	19.5	22.6	24.2	25.8
Depreciation / Amortization	283.1	323.5	587.7	616.8	540.0	434.6	456.3	456.3
EBIT	469.3	368.3	239.7	491.8	480.0	620.4	766.1	958.5
EBIT %	14.8	11.8	6.0	10.5	9.2	13.3	15.1	17.5
Finance costs	24.5	3.8	6.6	6.7	10.0	10.0	10.0	10.0
Investment income	2,356.3	2,182.7	2,225.7	1,896.5	2,785.0	2,048.0	2,150.4	2,257.9
PBT	2,801.1	2,547.2	2,458.8	2,381.6	3,255.0	2,658.4	2,906.5	3,206.4
Tax	376.9	339.9	437.8	324.1	406.0	525.3	581.3	641.3
ETR %	13.5	13.3	17.8	13.6	12.5	19.8	20.0	20.0
PAT before MI and associate profits	2,424.2	2,207.3	2,021.0	2,057.5	2,849.0	2,133.1	2,325.2	2,565.1
Minority Interest	248.5	244.1	213.3	363.5	446.0	0.0	0.0	0.0
Share of Associates profit	3.3	4.1	2.8	2.7	11.0	190.0	228.0	273.6
PAT after MI and Associate profits	2,179.0	1,967.3	1,810.5	1,696.7	2,414.0	2,323.1	2,553.2	2,838.7
Change (%)	-6.8	-9.7	-8.0	-6.3	42.3	-3.8	9.9	11.2
PAT margin %	68.7	63.1	45.0	36.2	46.2	49.7	50.5	51.8
Exceptional items	984.0	607.2	507.5	466.0	208.0	36.5	0.0	0.0
PAT after exceptional items	1,440.2	1,600.1	1,513.5	1,591.5	2,206.0	2,286.7	2,553.2	2,838.7

Balance Sheet								(INR M)
Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Total fixed assets	2,142	2,242	2,542	2,496	2,519	2,756	3,056	3,355
Non current investments	5,273	11,252	14,102	15,251	17,478	17,478	17,478	17,478
Other non current assets	636	867	940	1,327	1,128	1,171	1,208	1,237
Total non current assets	8,052	14,362	17,585	19,074	21,125	21,406	21,741	22,070
Cash & Current investments	28,747	25,306	23,184	21,474	29,278	27,454	35,691	37,807
Trade receivables	344	344	360	480	687	465	500	537
Other current assets	2,305	698	844	1,043	740	844	895	891
Total current assets	31,397	26,347	24,389	22,996	30,705	28,763	37,086	39,235
TOTAL ASSETS	39,448	40,709	41,974	42,070	51,830	50,169	58,827	61,305
Share Capital	104	104	107	107	108	108	108	108
R&S	22,786	23,604	24,502	24,385	26,516	26,758	33,595	34,163
Shareholders equity	22,889	23,708	24,609	24,493	26,624	26,866	33,703	34,270
Core SGF	8	56	1,113	1,761	2,045	2,045	2,045	2,045
Minority Interest	1,733	1,875	1,986	2,223	2,909	2,909	2,909	2,909
Deferred tax liabilities	55	96	27	2	0	36	32	19
LT borrowings	0	13	36	19	0	0	0	0
Other LT liabilities	2,756	601	648	719	88	88	88	88
Total non-current liabilities	2,811	710	710	739	88	124	120	107
Outstanding dues to creditors	371	470	581	697	563	563	563	563
Other current liabilities	11,627	13,891	12,975	12,158	19,601	17,662	19,488	21,411
Total current liabilities	12,007	14,360	13,556	12,854	20,164	18,225	20,051	21,974
TOTAL LIABILITIES	39,448	40,709	41,973	42,070	51,830	50,169	58,827	61,305

Financials and Valuations

Cash Flow Statement								(INR M)
Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
PBT	1,822	1,934	1,951	1,916	3,255	2,658	2,907	3,206
Depreciation	283	324	588	617	540	435	456	456
Contribution to SGF	0	0	258	174	208	36	0	0
Interest & Dividend income	-2,135	-1,977	-2,107	-1,901	-2,380	-1,649	-1,731	-1,818
Other adjustments	-132	-107	18	261	10	10	10	10
Working capital changes	2,549	2,103	-1,756	-825	7,754	-3,883	1,042	1,768
Taxes paid	-649	-548	-480	-733	-406	-525	-581	-641
CF - Operations	1,738	1,728	-1,528	-491	8,979	-2,918	2,102	2,981
Capital expenditure	-314	-446	-726	-623	-650	-700	-750	-800
FCF	1,424	1,283	-2,254	-1,115	8,329	-3,618	1,352	2,181
Other investment changes	1,314	-302	4,413	2,270	506	1,649	1,731	1,818
CF - Investments	1,000	-748	3,687	1,646	-144	949	981	1,018
Finance costs	-25	-2	-7	-7	-10	-10	-10	-10
Dividends including taxes	-821	-607	-607	-1,244	-670	-2,839	-4,258	-5,677
Others	-3,149	-2,102	159	34	-19	-36	0	0
CF - Financing activities	-3,995	-2,711	-455	-1,217	-698	-2,885	-4,268	-5,687
Net change in cash	-1,256	-1,730	1,704	-62	8,137	-4,854	-1,185	-1,688
Cash at beginning	20,484	14,695	14,525	16,101	24,258	22,434	30,671	32,787
Cash at end	19,228	12,964	16,229	16,039	32,394	17,581	29,486	31,099
Ratios								
Y/E March	2013	2014	2015	2016	2017	2018E	2019E	2020E
Basic (INR)								
EPS	21.8	24.8	23.8	24.4	41.0	128.7	46.8	52.0
EPS (excl EOI)	21.9	24.7	23.8	24.4	41.0	41.9	46.8	52.0
Cash EPS	27.0	30.7	34.5	34.2	51.0	136.7	55.1	60.4
Book Value	419.3	434.3	450.8	448.7	494.9	492.2	617.4	627.8
DPS	7.7	7.7	10.0	8.0	28.0	30.0	40.0	50.0
Payout %	35.6	31.3	42.1	32.9	68.3	23.3	85.5	96.2
Valuation (x)								
P/E				32.4	19.2	6.1	16.8	15.2
Cash P/E				23.1	15.4	5.8	14.3	13.1
EV/EBITDA				18.6	4.3	8.8	-3.6	-5.5
EV/Sales				3.0	0.8	1.3	-0.6	-0.9
Price/Book Value				1.8	1.6	1.6	1.3	1.3
Dividend Yield (%)				1.0	3.6	3.8	5.1	6.3
Profitability Ratios (%)								
RoE	5.2	5.7	5.3	5.4	8.3	8.5	7.6	8.3
RoCE	12.4	12.1	12.8	12.5	13.7	11.1	9.9	10.5
Turnover Ratios								
Debtors (Days)	45.8	47.1	36.4	41.2	48.5	40.0	40.0	40.0
Fixed Asset Turnover (x)	2.1	1.9	2.1	2.6	3.1	2.2	2.1	2.0

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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