

# OTC Markets Group

A further estimate upgrade

Q320 results and outlook

OTC Markets Group (OTCM) announced third quarter results with revenue and profit ahead of our expectation, as in Q220. This resulted from strong transaction volumes at OTC Link and higher user numbers and price increases for Market Data Licensing. The diversity of the group's income was evident as Corporate Services was flat year-on-year, although here a step up in client additions is encouraging for the future. Pandemic-related and political uncertainties may be less acute now, but, in any event, OTCM maintains its long-term focus on developing its cost-effective, efficient markets.

Year end	Revenue (\$m)	PBT (\$m)	EPS* (\$)	DPS** (\$)	P/E (x)	Yield (%)
12/18	59.3	19.8	1.36	1.23	25.4	3.6
12/19	62.8	18.0	1.25	1.25	27.8	3.6
12/20e	68.9	20.2	1.42	1.25	24.4	3.6
12/21e	70.4	21.3	1.44	1.25	24.0	3.6

Note: \*Fully diluted and calculated after restricted stock award allocation. \*\*Including special dividends of 65c each year for FY18–21e.

## Q320 results: Transaction and data fees drive beat

Group Q320 revenue of \$17.7m was up 13% y-o-y and 6% ahead of our estimate. OTC Link revenue was up 28% y-o-y on strong trading volumes, particularly at OTC Link ECN. Market Data Licensing revenue (+18%) was driven by a combination of price increases for, and usage by professional users, together with sharply higher non-professional user numbers. Corporate Services revenue was up just 1% but this was ahead of our estimate following two more difficult quarters for client numbers. Encouragingly, new client additions for both OTCQX and OTCQB markets increased markedly compared with the first and second quarters, although OTCQB still saw a modest net decline in clients in the period. Operating costs increased by 7% allowing pre-tax profit to increase by 15% to \$5.4m and net earnings by 11%. A maintained quarterly dividend of \$0.15 and a special dividend of \$0.65 (the same level as last year) were announced.

## Market background and outlook

Looking ahead, we assume trading activity levels will normalise in due course potentially reducing OTC Link revenues. However, the Corporate Services segment is set to benefit from fee increases of over 15% for corporate clients in both its premium markets in FY21 and may also be able to sustain the improvement in client additions seen recently. Market Data Licensing may see a pullback in user numbers, particularly non-professional users, but professional users account for a much larger proportion of revenue and their number tends to be more stable. The business also continues to develop new product offerings.

## Valuation

Our EPS estimates are increased by 9% and 16% for FY20 and FY21 respectively. OTCM's prospective P/E multiples remain below peers, while our DCF valuation increases from \$30.40 to \$35.00 reflecting the higher estimates.

## Financial services

24 November 2020

Price **US\$34.60**

Market cap **US\$404m**

Net cash (\$m) at 30 September 2020 28.6

Shares in issue 11.7m

Free float 63%

Code OTCM

Primary exchange OTCQX

Secondary exchange N/A

## Share price performance



% 1m 3m 12m

Abs 11.7 12.6 2.0

Rel (local) 8.2 6.9 (11.3)

52-week high/low US\$35 US\$23.0

## Business description

OTC Markets Group operates the OTCQX, OTCQB and Pink financial markets for over 11,000 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 84% of revenues were of a subscription-based recurring nature in 9M20.

## Next events

FY20 results March 2021

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## Cost-effective transparent 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.

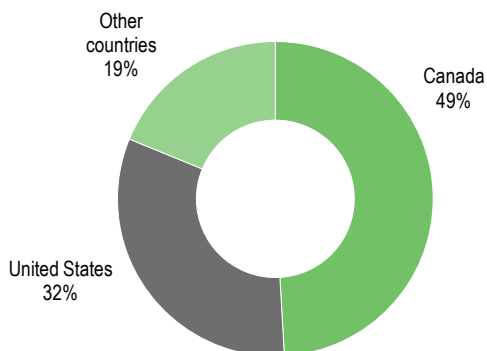
A platform providing real-time quotes was launched in 2003 and evolved into the current SEC-registered alternative trading system, OTC Link ATS. Another platform, OTC Link ECN, was launched in 2017, providing dealers with complementary features including an anonymous order-matching engine with an order routing capability – as opposed to OTC Link ATS, where attributable quotes are displayed and messages delivered, enabling direct trades between dealers. OTC Link ATS carries quotes in more than 11,000 companies and has 82 active broker-dealer participants, while OTC Link ECN has expanded its subscriber base and trading volumes rapidly since launch; at end September it had 69 subscribers, an increase of 22 over 12 months.

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.
- **OTCQB Venture Market** is intended to provide a public trading facility for developing companies that meet standards promoting price transparency and public disclosure. OTCQB companies must remain current in their disclosure and provide additional information for investors.
- 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.

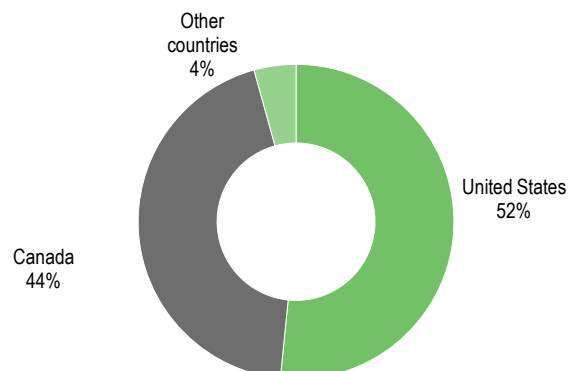
From the point of view of corporates, OTCM's premium markets, OTCQX and OTCQB, provide access to public trading in the US at a cost-effective price, compared with a listing on a registered national securities exchange such as Nasdaq. As shown in the charts below, both OTCQX and OTCQB have a substantial number of international corporate clients, notably from Canada.

**Exhibit 1: OTCQX Composite Index constituents**



Source: OTCM. Note: % of 383 constituents 28/10/20 (441 companies on OTCQX at end September 2020).

**Exhibit 2: OTCQB Venture Index constituents**



Source: OTCM. Note: % of 723 constituents 28/10/20 (874 companies on OTCQB at end September 2020).

The group's activities are organised in three divisions: OTC Link (trading services), Market Data Licensing and Corporate Services (OTCQX, OTCQB and other services), which in 9M20 accounted for 21%, 40% and 39% of gross revenues respectively. Exhibit 3 sets out examples of how revenues are generated within each division.

While OTC Link revenues are largely transaction-related, subscription-based revenues feature in many activities and for 9M20 subscription-based revenues accounted for 84% of the group total providing a measure of revenue resilience against the background of equity market volume fluctuations. The diversification of revenue streams is also helpful in this respect; in the current year the pandemic initially created difficult conditions for recruiting corporate clients while market volatility caused a jump in transaction levels for OTC Link. It may be that a normalisation of trading activity in due course will coincide with an improving macroeconomic outlook and hence a stronger period in Corporate Services.

### Exhibit 3: Revenue generation, examples by division

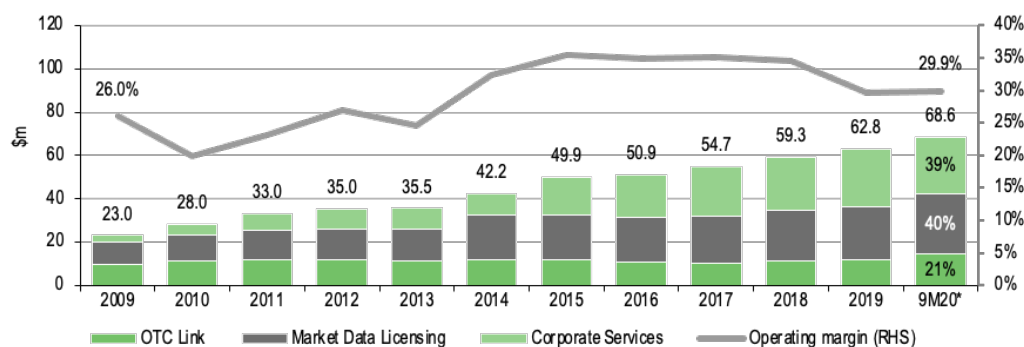
Segment	Comments
<b>OTC Link</b>	
OTC Link ATS	Broker-dealers pay subscriptions and usage fees related to the number of quotes and messaging volume.
OTC Link ECN	Fees are transaction-based with rebates for liquidity provision (maker-taker structure).
<b>Market Data Licensing</b>	
	Users subscribe to 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.
<b>Corporate Services</b>	
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 4 shows the long-term development of OTCM's gross revenue by division and its operating margin. Total gross revenue grew at a compound annual rate of 11% between 2009 and 2019. Within this, Corporate Services has contributed the fastest growth at 25%, mainly as a result of the development of the premium OTCQX and OTCQB markets both in terms of the number of corporate clients subscribing and the level of fees charged. Market Data Licensing CAGR was 9% and OTC Link 2%.

The operating margin increased significantly between 2013 and 2015 as the scale of the business grew, but was then flat between 2015 and 2018 as investment was made in people and systems to support sustainable growth in the business. 2019 saw further investment in staff and IT infrastructure together with a move to a new office in New York, resulting in a reduction in margin. The current year has seen a small increase in margin.

### Exhibit 4: Gross revenue and operating margin since 2009



Source: OTCM. Note: \*9M20 annualised, actual revenue \$51.5m.

## 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 fit well with the requirements of corporates, investors, broker-dealers and regulators involved in the OTC market.

On acquisitions, OTCM has been clear that it is not seeking a high-risk transformative transaction but continues to monitor opportunities for purchases that will provide complementary capabilities. An example is the acquisition of certain assets of Virtual Investor Conferences in January 2019, which has been developed with further investment and has seen strong demand in the current year when in-person meetings have not been possible. The business arranged 19 virtual conferences in 9M20 involving 232 companies and reaching over 18,000 investors.

OTCM continues to work towards further regulatory recognition for its two premium markets, including extending the list of states that grant exemptions under state Blue Sky laws governing secondary trading. The list currently includes 37 states for OTCQX and 33 for OTCQB giving population coverage of nearly 58% and over 53%, respectively. 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 (an ESOP Fairness Act has been introduced in the House and Senate this year).

## Q320 analysis

A summary of third quarter profit and loss figures is given in Exhibit 5 including Q220 and Q319 for comparison. We pick out key points below (comparisons are year-on-year unless stated).

- **Gross revenue** at \$17.7m increased by 13% following the 9% y-o-y increase recorded in the second quarter. The largest percentage increase was in OTC Link (+28%) reflecting heightened levels of equity trading resulting from market volatility and increased market share. Market Data Licensing contributed the largest absolute increase (\$1.1m or +18%) as a result of increased numbers of data users and price increases implemented at the beginning of the year. Having seen a small year-on-year decline in the second quarter, Corporate Services recorded a small increase helped by strong demand for virtual events from Virtual Investor Conferences (VIC).
- **Redistribution fees** (+14%) increased with higher data user numbers while **transaction-based expenses** (liquidity-provider payments), linked to the OTC Link ECN business, jumped with the activity level on this platform (+180%).
- **Operating expenses** (before depreciation and amortisation) increased by 7%, mainly reflecting salary and headcount increases (see Exhibit 5 and discussion below for further detail).
- As a result, income from operations and pre-tax profit were up 16% and 15% respectively. A return towards a more normal effective tax rate (at 18%) left **earnings per share** up 12% to \$0.37.
- A maintained quarterly **dividend** of \$0.15 and a special dividend of \$0.65 (at the same level as last year) were announced.

**Exhibit 5: Q320 results summary**

\$000s unless stated	Q319	Q220	Q320	y-o-y % change	q-o-q % change
OTC Link	2,989	3,659	3,816	28	4
Market Data Licensing	6,085	6,858	7,172	18	5
Corporate Services	6,682	6,582	6,759	1	3
<b>Gross revenues</b>	<b>15,756</b>	<b>17,099</b>	<b>17,747</b>	<b>13</b>	<b>4</b>
Re-distribution fees and rebates	(602)	(706)	(689)	14	(2)
<b>Net revenue</b>	<b>15,154</b>	<b>16,393</b>	<b>17,058</b>	<b>13</b>	<b>4</b>
Transaction-based expenses	(219)	(607)	(614)	180	1
<b>Revenues less transaction-based expenses</b>	<b>14,935</b>	<b>15,786</b>	<b>16,444</b>	<b>10</b>	<b>4</b>
Operating expenses (exc depreciation and amortisation)	(9,827)	(10,579)	(10,525)	7	(1)
Depreciation and amortisation	(384)	(415)	(441)	15	6
<b>Income from operations</b>	<b>4,724</b>	<b>4,792</b>	<b>5,478</b>	<b>16</b>	<b>14</b>
Other income / net interest	26	10	(35)		
<b>Income before provision for income taxes</b>	<b>4,750</b>	<b>4,802</b>	<b>5,443</b>	<b>15</b>	<b>13</b>
Taxes	(730)	(571)	(984)	35	72
<b>Net income</b>	<b>4,020</b>	<b>4,231</b>	<b>4,459</b>	<b>11</b>	<b>5</b>
Diluted EPS (\$)	0.34	0.36	0.37	12	5
Operating margin (%)	31.2	29.2	32.1		
Tax rate (%)	15.4	11.9	18.1		

Source: OTCM, Edison Investment Research

Exhibit 6 sets out an indicative subdivisional analysis of gross revenue based on management commentary in Q320 and Q319 reports. Within OTC Link this shows the scale of the increase in revenue for OTC Link ECN resulting both from the volatility in equity markets and a continued increase in the number of broker dealer participants. In Market Data Licensing the revenue increase for professional user licences was the main absolute contributor to growth. Non-professional users saw a dramatic 64% increase in number, but because these subscriptions are at a much lower price point the absolute contribution to growth was more modest. The Corporate Services numbers show modest reductions for both OTCQX and OTCQB revenues, reflecting the lower average number of company clients after a challenging period for new client signings (see Background and outlook section for further discussion). Virtual events (VIC) recorded very strong growth and other services also contributed to growth.

**Exhibit 6: Indicative subdivisional revenue analysis**

\$000	Q319	Q320	Change	Change %	Comments
<b>OTC Link</b>					
OTC Link ECN	424	1,098	674	159%	Elevated market volatility and subscribers up from 47 to 69
OTC Link ATS and other services	2,565	2,718	153	6%	Fewer broker dealers but messaging up with market volumes
	<b>2,989</b>	<b>3,816</b>	<b>827</b>	<b>28%</b>	
<b>Market Data Licensing</b>					
Professional user licence subscriptions			606		Price increase from 1 January plus 7% increase in users. Accounted for c 54% of segment H120
Non-professional users	419	687	268	64%	Users up 45% reflecting volatility and trend to higher retail participation. 10% of segment
Other			213		Compliance and other data services. c 35% of segment
	<b>6,085</b>	<b>7,172</b>	<b>1,087</b>	<b>18%</b>	
<b>Corporate Services</b>					
OTCQX	2,342	2,304	(37)	-2%	Average number of companies slightly lower
OTCQB	2,860	2,747	(113)	-4%	Average number of companies was 4% lower
Virtual Investor Conferences	61	172	111	183%	Strong demand for virtual events
Other	1,420	1,536	116	8%	Disclosure & News Service price increase and higher activity at News Release service
	<b>6,682</b>	<b>6,759</b>	<b>77</b>	<b>1%</b>	

Source: OTCM, Edison Investment Research. Note: Subdivisional absolute numbers are nearly all calculated from absolute and percentage changes given in both the Q319 and Q320 reports and are therefore approximate.

Our next table summarises the change in operating expenses with commentary on the year-o-year changes. As noted above, the main contributor to overall expense growth was staff costs. Other points to highlight are that IT costs were flat as prior year one-off costs dropped out balancing

ongoing investment in security and other areas, while occupancy costs were inflated in this quarter by the retroactive billing of certain costs.

<b>Exhibit 7: Analysis of operating expenses</b>						
<b>\$000s unless stated</b>	<b>Q319</b>	<b>Q220</b>	<b>Q320</b>	<b>Absolute change y-o-y</b>	<b>% change y-o-y</b>	<b>Comments on y-o-y change</b>
Compensation and benefits	6,533	7,380	7,052	519	7.9	Headcount and salary increases + higher commissions related to OTCQX and OTCQB sales
IT Infrastructure and information services	1,650	1,560	1,642	(8)	(0.5)	One-off data centre costs dropped out and lower costs following office move offset investment in security and support for ECN and new product
Professional and consulting fees	489	725	586	97	19.8	Higher ECN clearing costs with volume + support costs for VIC business
Marketing and advertising	256	167	138	(118)	(46.1)	Lower travel and entertainment spend
Occupancy costs	569	534	877	308	54.1	Certain building charges retroactively billed by sublandlord in Q320
Depreciation and amortisation	384	415	441	57	14.8	Higher following acquisition of Qaravan, investment related to new HQ and in two data centres
General, administration and other	330	213	230	(100)	(30.3)	Project management costs incurred in 2019 dropped out
<b>Total</b>	<b>10,211</b>	<b>10,994</b>	<b>10,966</b>	<b>755</b>	<b>7.4</b>	

Source: OTC Markets Group, Edison Investment Research

Exhibit 8 shows changes in operating data and related revenue data. Under **OTC Link** the dollar volume of trades was higher year-on-year in each market segment as equity market volatility continued. Sequentially, OTCQB, which had been relatively subdued in Q220, showed a marked pickup in activity, while OTCQX and Pink retreated somewhat from their peak levels probably reflecting sectoral rotation as investors sought to adjust to changing expectations. The number of OTC Link ATS participants saw a further decline but ECN subscribers continued to increase.

**Corporate Services** figures show sequential and year-on-year increases in OTCQX clients while OTCQB saw a further modest erosion, albeit the rate of new client additions increased significantly (see Exhibit 14 in next section).

For **Market Data Licensing** the salient feature is the 45% y-o-y jump in non-professional subscribers. OTCM has consistently noted that these subscriber numbers have been much more volatile than the professional subscribers, so it remains to be seen what level will be retained when equity market trading activity normalises. Positively, there has been a longer-term trend for higher retail involvement in the equity market with factors cited by OTCM including robo-investing platforms, fractional trading and zero trading commissions so some portion of the new subscribers may prove sticky. As noted earlier, the larger impact on segment revenues has been the more modest increase in professional users (and price increases).

**Exhibit 8: Operating and related revenue data**

	Q319	Q220	Q320	% change y-o-y	% change q-o-q
<b>OTC Link</b>					
Dollar volume traded (millions)					
OTCQX	15,277	18,807	17,021	11.4	(9.5)
OTCQB	6,256	5,814	6,942	11.0	19.4
Pink	60,931	82,380	69,988	14.9	(15.0)
Number of securities quoted	10,609	11,336	11,381	7.3	0.4
Number of active ATS participants	90	85	82	(8.9)	(3.5)
Number of ECN subscribers	47	64	69	46.8	7.8
New form 211 filings	77	64	69	(10.4)	7.8
Revenue per security quoted (\$)	282	323	335	19.0	3.9
<b>Corporate Services</b>					
Number of corporate clients (period end)					
OTCQX	436	415	441	1.1	6.3
OTCQB	915	885	874	(4.5)	(1.2)
Pink	749	690	722	(3.6)	4.6
Total	2,100	1,990	2,037	(3.0)	2.4
Revenue per client (\$)	3,194	3,303	3,357	5.1	1.6
Graduates to a national securities exchange	14	9	19	35.7	111.1
<b>Market Data Licensing</b>					
Market data professional users	21,446	22,533	22,926	6.9	1.7
Market data non-professional users	13,892	16,545	20,102	44.7	21.5
Revenue per terminal (total - \$)	172	175	167	(3.2)	(5.0)
Market data compliance file users	38	44	44	15.8	0.0

Source: OTCM, Edison Investment Research

## Regulatory developments

Among the regulatory developments highlighted by OTCM in its quarterly report are the SEC's final rule amending Exchange Act Rule 15c2-11 (26 September) and Consolidated Audit Trail obligations. **Rule 15c2-11** deals with information requirements before quotes may be published on interdealer quotation systems such as OTC Link ATS. Positively, the amended rule recognises OTCM markets' disclosure standards and OTC Link ATS will be permitted to act as a qualified IDQS (interdealer quotation system) reviewing disclosure to determine whether a security is eligible for public quoting. This will enable it to streamline onboarding of securities to OTCM's markets, removing the risk and administrative burden of certifying the suitability of securities for quotation from broker dealers, which in turn will allow them to focus on their financial advisory role. For companies that do not meet the information requirements there is the potential for an expert market exemption allowing sophisticated or professional investors to continue to trade in the securities. OTCM has already established an Expert Market and is continuing to engage with the SEC with the aim of refining implementation of the amended rule to provide well-informed markets for its corporate clients, broker dealers and investors. The group expects to invest significantly (at a level yet to be determined) in technology and personnel to comply with the rule ahead of the 26 September 2021 deadline.

The initial phase of **Consolidated Audit Trail** (CAT) obligations for OTC trading began in June 2020 with subsequent obligations taking effect in 2021. The prospective costs for firms such as OTC Link LLC and other FINRA broker dealer members to fund the database of trading activity have yet to be established and there are also costs involved in building the capability to submit trade reports to meet CAT requirements.

Otherwise OTCM continues to work towards increasing regulatory recognition for its markets including the number of states granting Blue Sky recognitions for OTCQX and OTCQB (unchanged in Q320).

## Background and outlook

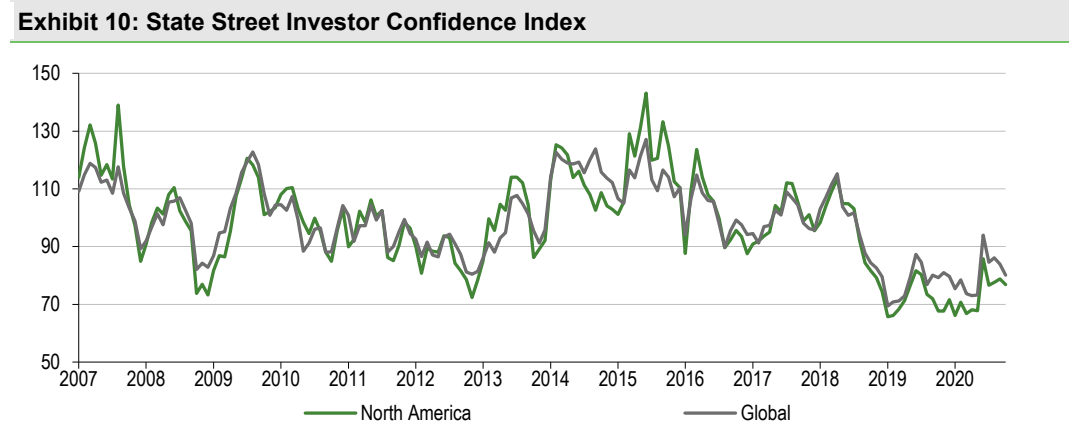
We start with a table of recent equity market index performance. Strikingly, after a period of accentuated volatility, most indices over most of the periods shown are in positive territory, with the bounce since the initial onset of the pandemic particularly evident in the six-month figures.

**Exhibit 9: Recent market index performance (total return %)**

Period	S&P 500	Nasdaq Composite	OTCQX Composite	OTCQB Venture	S&P TSX Venture
	US\$	US\$	US\$	US\$	C\$
3 months	5.5	5.4	20.1	1.5	0.2
6 months	20.8	27.0	32.4	24.5	38.8
1 year	16.6	40.4	16.0	-3.3	41.7
Year to date	11.9	33.3	17.2	0.8	28.5

Source: Bloomberg. Note: Priced on 23 November 2020.

In Exhibit 10 we show the readings from State Street Investor Confidence Index from just before the global financial crisis in 2008/2009. This indicator tracks changes in institutional investor holdings of risky versus safer investments. On this measure, the level of confidence bounced following the financial crisis, later peaking in 2015 then declining to a lower level in 2018/19 coinciding with global trade tensions followed by the pandemic this year. Confidence did recover quite sharply following the initial onset of the pandemic but, as can be seen, the latest readings suggest greater caution and do not capture more encouraging recent news relating to vaccines that may curtail the impact of COVID-19.

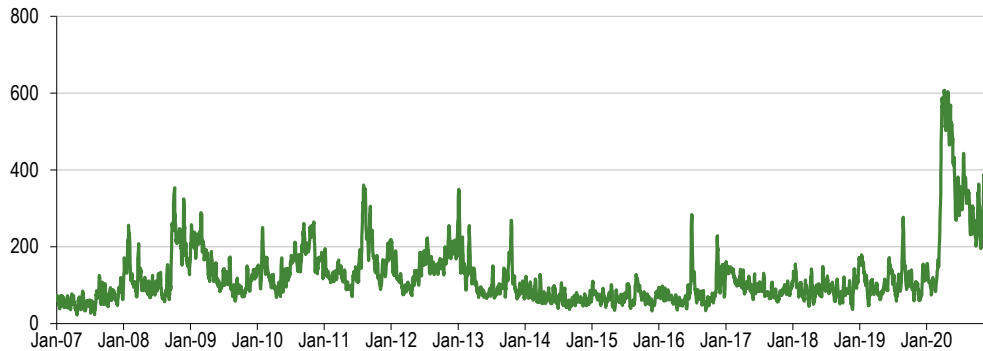


Source: Bloomberg, State Street

Another indicator of the environment for corporate decision-making is the Economic Policy Uncertainty [Index](#) shown below. The index component selected here reflects daily newspaper coverage related to economic uncertainty and shows the substantial impact of the pandemic compared with the global financial crisis, for instance. Reflecting the nature of its compilation, the index does show a more severe spike with the arrival of the pandemic and more marked subsequent easing than the investor confidence index but remains at elevated levels.



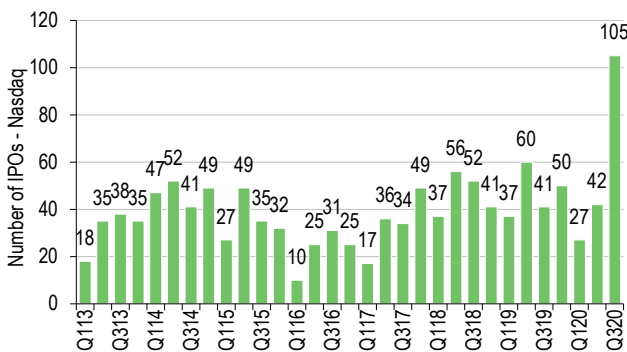
**Exhibit 11: Economic Policy Uncertainty Index (newspaper-based, five-day rolling average)**



Source: 'Measuring Economic Policy Uncertainty' by Scott Baker, Nicholas Bloom and Steven J. Davis at [www.PolicyUncertainty.com](http://www.PolicyUncertainty.com).

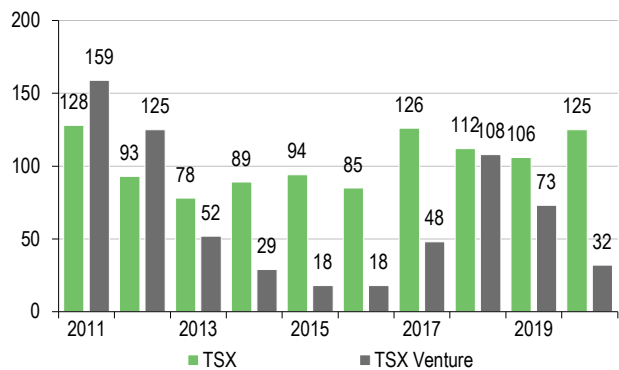
Next, we show the trends in numbers of IPOs on the Nasdaq, TSX and TSX Venture exchanges. For Q320 the number of IPOs on Nasdaq bounced strongly (Exhibit 12), up 156% y-o-y compared with 27% and 30% y-o-y reductions for the first and second quarters respectively. TSX IPOs to end October were up 37% while in contrast the TSX Venture exchange saw a 48% drop in IPOs; in terms of IPO money raised both were strongly up year-on-year: +392% and +278% respectively. While the number of IPOs in the higher risk TSX Venture market was down, the positive trend in other data suggests an appetite among corporates and investors to take opportunities and look beyond the pandemic and other current market uncertainties.

**Exhibit 12: Nasdaq – number of IPOs**



Source: Nasdaq

**Exhibit 13: TSX and TSX Venture – number of IPOs**



Source: TMX

We highlighted earlier the increase in the number of corporate client additions for both OTCQX and OTCQB in Q320. For OTCQX there were 44 additions in the third quarter compared with nine and 19 in Q120 and Q220. The net increase in Q320 was 26 to 441 (see earlier Exhibit 8). OTCQX renewals are annual on a calendar year basis.

Exhibit 14 sets out the figures behind the downtrend in OTCB client numbers in recent quarters. Looking at the current year, the number of new additions was particularly depressed in the first quarter, as would be expected, but has improved in the second and third quarters. OTCQB client renewal is annual or semi-annual, based on when companies originally signed contracts, and renewals are spread broadly evenly between quarters. The level of voluntary non-renewals was lower in Q320 (c 3%) and has averaged 5% for 9M20 compared with 6% in FY19. Other departures, including compliance downgrades (which help protect the quality of the market), were at a higher rate in Q320 (c 7%) but the 9M20 rate (5%) was only slightly above the FY19 level.

**Exhibit 14: OTCQB corporate client evolution**

	Q119	Q219	Q319	Q419	Q120	Q220	Q320
<b>Start</b>	<b>934</b>	<b>941</b>	<b>916</b>	<b>915</b>	<b>907</b>	<b>893</b>	<b>885</b>
Additions	68	38	53	43	28	45	62
Voluntary non-renewal	(15)	(15)	(14)	(14)	(14)	(17)	(7)
Other (compliance downgrades, other)	(46)	(48)	(40)	(37)	(28)	(36)	(66)
<b>End</b>	<b>941</b>	<b>916</b>	<b>915</b>	<b>907</b>	<b>893</b>	<b>885</b>	<b>874</b>
Net change	7	(25)	(1)	(8)	(14)	(8)	(11)

Source: OTCM, Edison Investment Research. Note: Start, end and additions (new sales) figures are reported while voluntary non-renewal figures are based on indicated percentages and the compliance downgrade and other figure is a residual.

Beyond the third quarter, OTCM reports that the trends have been encouraging with OTCQB seeing net client additions in both September and October, while there are good pipelines for both OTCQX and OTCQB and high levels of issuer engagement, including international companies. It remains to be seen whether the market background allows this positive trend to continue into 2021 but Q420 appears to have started well.

A positive factor for Corporate Services revenue in 2021 will be annual/semi-annual fee increases for OTCQX and OTCQB of between 15% and 16.7% for companies renewing from January onwards. These are the first increases since 2016 for OTCQX and 2018 for OTCQB. The effect will be immediate for OTCQX but phased for OTCQB with the full benefit seen in 2022 given the incidence of renewals.

Turning to OTC Link, the group indicated that trading levels have continued at very high levels into October and November. Looking further ahead, it seems reasonable to expect a moderation of market volatility and trading activity. OTC Link ECN should nevertheless still benefit from its enlarged subscriber base.

Market Data and Licensing should continue to benefit in the fourth quarter from price increases introduced this year and beyond this from the increased subscriber numbers reported. The subscription-based nature of revenues provides resilience although, in the event of a longer-term economic downturn, subscription numbers could contract again for a period. Compliance data has been an area of growth within the division but OTCM believes it has captured a large part of the available market. Nevertheless, new introductions such as the Blue Sky Data Product, launched in September, should help broaden the market opportunity (the product provides compliance data on 16,000 OTC equity and 80,000 OTC fixed income securities).

## Financials

Key figures from our revised estimates are shown in Exhibit 15 and further detail is given in the financial summary (Exhibit 18). For FY20 our revenue estimate is increased by 3% with similar increases for each division. For FY21, where our revenue estimate is increased by 5%, the main change has been an increase in Corporate Services to allow for the fee increases announced in September and also an assumption of a more favourable trend in corporate client additions. As before, we factor in some normalisation of equity market trading activity levels, assuming that OTC Link FY21 revenues are 10% lower than our FY20 estimate. With expense assumptions little changed, our diluted EPS estimates for FY20 and FY21 increase by 9% and 16% respectively.

We note that although there is currently more positive news on potential vaccines for COVID-19, the development of the pandemic and its economic ramifications remain uncertain. Our FY21 estimate would be likely to prove optimistic were a more sustained economic downturn to emerge in place of the recovery consensus expectations point to.

**Exhibit 15: Estimate revisions**

	Gross revenue (\$m)			PBT (\$m)			Diluted EPS (\$)			Dividend (\$)		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
2020e	66.9	68.9	3.0	18.6	20.2	8.4	1.30	1.42	8.6	1.25	1.25	0.0
2021e	67.2	70.4	4.8	18.4	21.3	15.5	1.25	1.44	15.7	1.25	1.25	0.0

Source: Edison Investment Research. Note: Dividends include the special dividend of 65c announced for FY20 and estimated for FY21.

OTCM's balance sheet remains strong with no debt and cash of \$28.6m or \$30.2m including restricted cash. Operating cash flow for the first nine months of 2020 (9M20) was \$10.3m of which \$0.9m was allocated to capital expenditure (IT infrastructure), \$5.2m dividends and \$3.5m purchases of treasury stock. In addition to the cash held OTCM has an undrawn line of credit of up to \$1.5m available.

## Sensitivities: Macro, regulatory and IT resilience

- 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 and the amendment of rule 15c2-11 may speed the onboarding of securities to OTCM's markets, while Regulation Systems, Compliance and Integrity (SCI) requires ongoing technology investment to ensure compliance and introduction of the Consolidated Audit Trail will also entail additional costs.
- Reliability of the group's IT systems is also important from a reputational perspective and OTC Link 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.

## Valuation

We have updated our comparative P/E table in Exhibit 16. This includes information providers MSCI and Markit together with the average multiples for global exchanges. OTCM shares are trading on prospective P/Es below the average for exchanges and noticeably below those for information providers. To some extent the discount can be attributed to the relative illiquidity of OTCM shares and to its exposure to smaller companies through its venture market. Positively, the group is financially strong and has a high proportion of subscription-based revenues.

**Exhibit 16: OTCM comparative multiples**

	P/E ratios (x)	
	2020e	2021e
MSCI	51.4	47.4
Markit	32.7	28.7
Average information providers	42.0	38.0
Average global exchanges	26.9	25.6
<b>OTCM</b>	<b>24.4</b>	<b>24.0</b>

Source: Refinitiv, Edison Investment Research. Note: Prices at 23 November 2020.

The sensitivity of our discounted cash flow valuation to different discount rates and long-term growth assumptions is shown in the next table. The model factors in our increased explicit forecasts for FY20/21, together with an assumption of FY22–23 cash flow growth of 8%, long-term growth of 4% and a terminal cash flow multiple of 16x. At a discount rate of 10% these assumptions give a value of \$35.00 per share (\$30.40 previously but with 12% growth FY22–23 from a lower base).

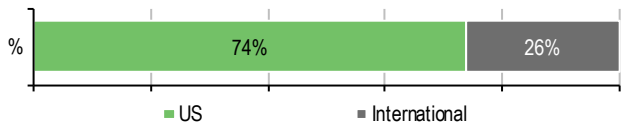
<b>Exhibit 17: Discounted cash flow valuation sensitivity (\$ per share)</b>					
<b>Discount rate (right)</b>	<b>8%</b>	<b>9%</b>	<b>10%</b>	<b>11%</b>	<b>12%</b>
<b>2024–30e growth</b>					
<b>3%</b>	38.2	35.7	33.5	31.5	29.6
<b>4%</b>	39.9	37.3	<b>35.0</b>	32.8	30.8
<b>5%</b>	41.8	39.0	36.5	34.2	32.1
<b>6%</b>	43.7	40.8	38.1	35.7	33.5

Source: Edison Investment Research

**Exhibit 18: Financial summary**

\$000s	2016	2017	2018	2019	2020e	2021e
Year end 31 December						
<b>PROFIT &amp; LOSS</b>						
OTC Link	10,573	10,074	11,175	11,676	14,245	12,820
Market Data Licensing	21,054	21,922	23,384	24,447	27,967	28,247
Corporate Services	19,254	22,660	24,719	26,716	26,716	29,302
Revenue	50,881	54,656	59,278	62,839	68,928	70,369
Re-distribution fees and rebates	(2,317)	(2,480)	(2,448)	(2,489)	(2,815)	(2,825)
Net revenue	48,564	52,176	56,830	60,350	66,113	67,544
Transaction-based expenses	0	0	(375)	(746)	(2,176)	(1,667)
Revenues less transaction-based expenses	48,564	52,176	56,455	59,604	63,936	65,878
Operating expenses	(30,032)	(32,511)	(35,768)	(40,230)	(42,047)	(42,886)
EBITDA	18,532	19,665	20,687	19,374	21,889	22,991
Depreciation	(1,606)	(1,361)	(1,042)	(1,492)	(1,710)	(1,727)
Operating profit	16,926	18,304	19,645	17,882	20,179	21,264
Net interest	9	47	116	103	0	40
Profit Before Tax	16,935	18,351	19,761	17,985	20,179	21,304
Tax	(6,407)	(5,792)	(3,524)	(3,043)	(3,232)	(4,048)
Profit after tax	10,528	12,559	16,237	14,942	16,948	17,257
Profit after tax and allocation to RSAs	10,252	12,241	15,840	14,588	16,594	16,903
Average Number of Shares Outstanding (m)	11.3	11.6	11.6	11.7	11.7	11.7
EPS - basic (c)	92.4	109.9	140.8	128.4	145.7	148.3
Fully diluted EPS (c)	90.4	105.8	136.3	124.7	141.5	144.1
Dividend per share (c)	116.0	116.0	123.0	125.0	125.0	125.0
EBITDA Margin (%)	38	38	36	32	33	34
Operating profit margin (%)	35	35	35	30	31	31
<b>BALANCE SHEET</b>						
Non-current assets						
Intangible assets	291	362	312	291	247	174
Property and other	3,267	3,506	4,584	25,034	22,800	22,446
Current assets						
Debtors	6,262	6,450	4,942	5,157	5,802	5,802
Cash & cash investments	25,034	23,683	28,813	28,217	29,464	36,542
Other current assets	1,789	2,316	2,998	1,656	1,985	1,985
Current liabilities						
Deferred revenues	(14,664)	(15,531)	(16,070)	(15,815)	(15,815)	(17,346)
Other current liabilities	(5,372)	(5,644)	(6,711)	(9,574)	(9,673)	(9,673)
Long-term liabilities						
Tax, rent and other	(1,101)	(1,351)	(2,459)	(17,293)	(15,465)	(15,465)
Net assets	15,506	13,791	16,409	17,673	19,345	24,465
NAV per share (\$)	1.36	1.21	1.42	1.52	1.66	2.10
<b>CASH FLOW</b>						
Operating cash flow	21,752	21,629	24,442	23,044	24,787	26,972
Net Interest	9	47	116	103	0	40
Tax	(6,021)	(5,193)	(1,968)	(1,734)	(4,014)	(4,048)
Capex / intangible investment	(415)	(1,165)	(549)	(5,516)	(1,184)	(1,300)
Financing / investments	(1,157)	(3,407)	(2,716)	(1,933)	(3,760)	0
Dividends	(13,059)	(13,262)	(14,195)	(14,560)	(14,582)	(14,587)
Net cash flow	1,109	(1,351)	5,130	(596)	1,247	7,077
Opening net (debt)/cash	23,925	25,034	23,683	28,813	28,217	29,464
Closing net (debt)/cash	25,034	23,683	28,813	28,217	29,464	36,542
Cash and restricted cash	25,244	24,375	30,534	29,778	31,025	38,103

Source: OTC Markets Group annual reports, Edison Investment Research

<b>Contact details</b> 300 Vesey Street 12th Floor New York, NY 10282 US +1 (212) 896-4400 www.otcm Markets.com	<b>Revenue by geography (2019)</b>  <table border="1"> <thead> <tr> <th>Geography</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>US</td> <td>74%</td> </tr> <tr> <td>International</td> <td>26%</td> </tr> </tbody> </table>	Geography	Percentage	US	74%	International	26%								
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US	74%														
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<b>Management team</b>															
<b>Chairman: Neal Wolkoff</b> 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.	<b>CEO, president, director: R Cromwell Coulson</b> In 1997, Cromwell led a group of investors in acquiring OTCM's predecessor business, the National Quotation Bureau (NQB). He is responsible for the group's overall growth and strategic direction. Prior to OTCM, Cromwell was an institutional trader and portfolio manager in distressed and value-oriented investments.														
<b>EVP Market Data: Matthew Fuchs</b> Matthew Fuchs is responsible for product development, distribution and sales of market data. Prior to OTC Markets he held a number of financial technology roles at National Research Exchange, Bearing Point and Arthur Anderson.	<b>EVP Issuer and Information Services: Lisabeth Heese</b> Lisabeth Heese joined OTC Markets in 2004 as director of Issuer and Information Services subsequently building a team responsible for collecting and maintaining corporate and securities data for over 10,000 companies. Prior to OTCM she spent 11 years at Nasdaq as a product manager.														
<b>President OTC Link LLC: Michael Modeski</b> Michael Modeski joined OTCM in 2011. He has over 15 years' experience in the financial markets with a focus on OTC markets. Previous roles include director of broker-dealer execution services and sales at Citigroup, director of execution services at Lava Technology (Citigroup), director of OTC equities at FINRA and several management positions at Pershing.	<b>Chief Financial Officer: Beatrice (Bea) Ordonez</b> Bea Ordonez 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.														
<b>Chief Technology Officer: Bruce Ostrover</b> Bruce Ostrover joined OTCM in 2017 as CTO. He has over 30 years' experience in the financial services industry with a focus on software development and project management. Before OTCM he served as managing director at Convergenx, was a founding partner in a consulting firm and held senior IT roles in the financial services sector.	<b>Director, OTCM Intl and EVP Corporate Services: Jason Paltrowitz</b> Jason Paltrowitz joined OTCM in 2013 and manages the group's international and domestic Corporate Services business, supporting companies that trade on the OTCQX and OTCQB markets. His previous experience includes a range of senior management roles at JP Morgan Chase and BNY Mellon.														
<b>General Counsel: Dan Zinn</b> Dan Zinn joined OTCM in 2010 and is the group's general counsel and corporate secretary. He leads the company's regulatory and policy making efforts. 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).															
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