

3 January 2021

CMP: Rs. 634

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Company Background

BSE Limited (BSE), Asia's first stock exchange established in 1875 and has a rich history of the past 145 years. BSE is the fastest stock exchange in the world with 6 microseconds in response time (having emerged 10x faster than the closest competitor). It is the largest stock exchange in terms of the number of companies listed with 5,377 (as of FY2020). Currently, BSE is the 9th largest stock exchange globally having a market cap of \$2.22 trillion (combined value of all stocks traded on BSE) as per the World Federation of Exchanges. We recommend a BUY call on BSE for the following investment rationale:

Investment Rationale

- **BSE is evolving itself from mere Stock Exchange to an Exchange of Financial Markets** and also expanding the operations of stock exchange business. Recently promoted its Indian International Exchange India INX enjoys 79% market share;
- **A deep value stock:** Its Net Cash (net of liabilities) is 74% of its market cap and net cash plus current market value of investments in CDSL is 113% of its market cap;
- **Listing Fee Income** is emerging as a major profit contributor, addressing the concern on loss of market share in equity transaction business;
- **Impressive rewards to Shareholders:** On expected dividend of Rs.35/ per share for FY2021, it trades at a dividend yield of 5.5%. BSE did a buyback of over 13% of its paid up capital at a huge premium in FY2020 – it is quite rare to see such magnitude of buyback among the listed stocks;
- **Potential Listing of National Stock Exchange (NSE) on its own platform** could be a positive development for BSE;
- **Business model and price points give a lot of comfort:** BSE operates in a business which was running smoothly even during the pandemic time and hence, proven to be a defensive business. Current stock price is 21% below its IPO price and is down 47% from its post-listing peak price of Rs.1,200/.

BSE: Key Financials (Consolidated)

Y/E March (Rs. crore)	FY19	FY20	FY21E	FY22E
Total Income	687.44	630.00	680.00	761.00
Growth %		-8%	8%	12%
EBIDTA	240.28	130.21	254.00	290.00
EBITDA Margin (%)	35%	21%	37%	38%
Net Profit from total operations	199.28	120.61	175.50	216.00
Growth %		-40%	45%	23%
EPS (Rs)	36.85	24.57	39.00	48.00
PE (x)	17.2	25.8	16.3	13.2

Source: BSE; Equinomics;

Valuation and Outlook: Initiate with a BUY Call

We expect significant jump in revenues from Listing Fees and also from Equity Transaction charges especially in FY2022 due to possible listing of NSE exclusively on BSE. We also believe that post-listing of NSE, the valuation of BSE would improve. Hence, we initiate our BUY recommendation on BSE with a target price of Rs.1,000/- (with 12-18 months investment horizon) which is ~21x its FY2022E EPS of Rs.48/-

CMP (Rs) as of (Jan 1, 2020)	634
Upside (%)	58%
High/Low	649/275
Market cap (Cr)	2,859
No. of shares (Cr)	4.5

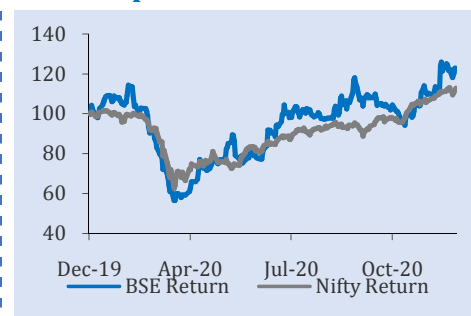
Shareholding (%)

As on Sep 30, 2020	
Promoter	0.00%
Non-promoter, non-public	29.48%
Of which, corporate trading members	11.69%
LIC	5.61%
Other trading members	10.57%
Public	70.52%
Of which, FPIs	12.47%
MFs	2.63%
Corporate Bodies	5.97%
Total	100%

Key Ratios

Y/E Mar (Rs Cr)	FY20	FY21E	FY22E
EPS Rs.	24.90	39.00	48.00
PE x	25.5	15.9	13.2
Book Value Rs.	494	540	560
EBITDA Margin (%)	21%	37%	38%
Dividend Rs./share	17	38	45

Relative performance



Source: Company, Equinomics Research

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BSE: Evolving from Stock Exchange to an Exchange of Financial Markets

BSE is diversifying from just a stock exchange to providing several segments of financial services and also non-financial services segments on exchange platform:

- **Trading of Commercial Papers:** BSE crossed listing of Rs.4 lakh crore worth of Commercial Papers on its exchange platform in FY2020;
- **Mutual Funds Distributor platform, StAR MF:** This platform of BSE has emerged as the largest mutual fund distribution Infrastructure with close to 78% of market share amongst similar platforms in mutual funds Industry as of Q2FY2021. In FY2020, BSE StAR MF crossed 5.75 crore transactions witnessing 60% growth as compared to 3.59 crore transactions in FY2019. The platform also registered 33,727 new independent financial advisors in FY 2020, taking the total number of distributors to approximately 57,000 on the platform. Management's decision to explore options to unlock value from its Star MF segment is encouraging;
- **Bond platform:** BSE launched this exchange platform in July, 2016, to facilitate online bidding for the private placement of debt securities. BSE has a current market share of 52% as of Q2FY2021. Since inception companies have garnered over Rs. 12.68 lakh crore through the exchange mechanism;
- **SME platform:** SME platform of BSE enjoys a 61% market share turning out to be a significant opportunity for BSE. Currently, 330 SMEs having a market capitalization of Rs.21,532 crore are listed;
- **BSE Currency Derivatives:** BSE enjoys 30% Market Share. The currency derivatives platform of BSE is gaining momentum with an average daily turnover stood at Rs.28,815 crore as of FY2020 while the average daily contracts have increased to 3.89 million contracts (CAGR growth 22%) in the last 4 years;
- **BSE Start-ups:** BSE has rolled out this platform, which would enable and facilitate funding for deserving start-ups by raising capital from the market. Indian stock exchanges are likely to see a spurt in start-up listings as nearly 58% of Indian start-ups are planning to list on domestic bourses in the coming five years;
- **E-agricultural spot market platform 'BSE E-Agricultural Markets (BEAM):** BSE launched this platform through its subsidiary BSE Investments in December 2020;

Further, BSE has proposed to diversify into Insurance Distribution, Power Exchange and also a new service to provide valuation of Fixed Income Securities:

- BSE has signed a Memorandum of Understanding in 2019 with IHS Markit, a reputed global information services provider, to facilitate offering of a new service to provide a valuation of Fixed Income Securities in India;
- **Insurance Distribution:** BSE Ltd has joined hands with EbixInc a US-based insurance exchange to set up a joint venture firm for building a robust insurance distribution network in India for which the exchange has recently got approval from IRDA. Ebix is a leading international supplier of on-demand software and e-commerce services to the insurance, financial, e-governance, and healthcare industries;
- **Power Exchange:** BSE is also setting up a new power exchange in association with PTC India and ICICI Bank for which it has already applied for the license to power market regulator, Central Electricity Regulatory Commission. It is worth noting that PTC India already offers a significant business to the existing energy exchange and the same possibly could move to this new joint venture;

This evolution of BSE (from an exchange of mere stock markets to the gamut of several financial instruments and commodities) gives us enormous confidence in the long-term prospects of the stock.

A Deep Value Stock: Net Cash plus value of CDSL investment, more than its Market caps

As of September 30, 2020 (Consolidated)	Amount (Rs. crore)
BSE Current Market Cap	2,859
1. Cash and cash-equivalent - Current Assets	
Cash and Bank Balance plus Long-term investments in Mutual Funds minus Other Financial Liabilities	2,121
% of the Current Market Cap.	74%
2. Value of Investments in CDSL* (20% Stake)	1,112
Total: Net Cash + Value of Investments in CDSL (1+2)	3,233
Cash plus value of investment in CDSL as % of Current Market Cap.	113%
3. Total Investments in Subsidiaries at Cost	689

Source: BSE and Equinomics Research

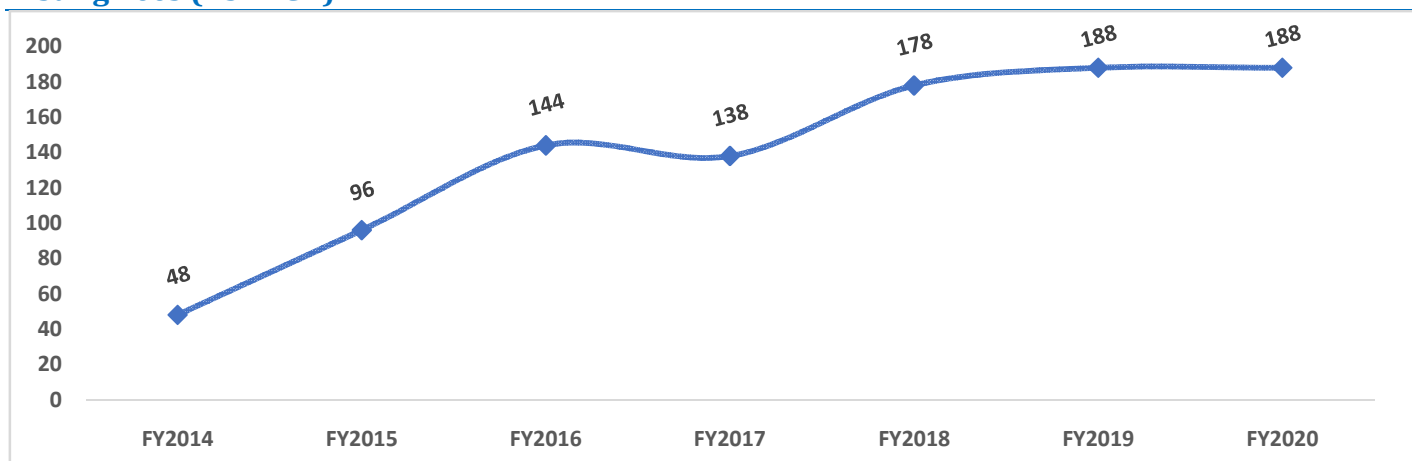
It is quite rare to see a deep value stock like BSE. **An institution operating successfully for nearly one-and-half century, engaged in almost duopoly market structure (a market dominated by just two players) and giving impressive rewards to shareholders in terms of dividends or buyback offers, is seeing its core operating business valued virtually at zero by the market as its net cash plus current value of its investment in listed security is more than its own market cap!** It is worth noting that:

- **BSE started unlocking value from its investment in CDSL** as it divested 4% stake for a sum of Rs.91.58 crore in FY2020. BSE retains balance 20% stake in CDSL and there is a possibility of frequent profit booking in this stock;
- **Apart from cash holding and value of investment, BSE has also invested Rs.689 crore in its subsidiaries** which are engaged in diversified exchange businesses and **some of them hold some unlocking potential in the long run;**

Listing Fee Income: A Promising Growth Segment for BSE

A major reason for the lower valuation of BSE by the market is due to low market share in equity transaction business. BSE is estimated to have just around 6% market share while NSE has the balance of 94%. There are concerns that BSE is losing market share to NSE in securities transactions. However, it is interesting to note that for BSE, the income from Transaction Charges of Securities Services is just about 25% of total operating revenues while **revenue from Listing Fees has grown much faster in the recent years and it has grown to 42% of total operating revenues in FY2020.**

Listing Fees (Rs in Cr.)



Source: Company, Equinomics Research

It is interesting to know that BSEs listing fee income has grown 4 folds from Rs.48 crore in FY2014 to Rs.188 crore in FY2020. Listing Fee segment earned revenue of Rs.188 crore, much higher than the revenue (Rs.113 crore) earned from Securities Transaction Charges in FY2020. We rarely see any new companies getting listed only on NSE - **most IPOs are listed on both BSE and NSE as the regulatory guidelines indicate that IPOs are listed at least on two exchanges. But there is no 3rd exchange which could pose any competitive threat to NSE and BSE.** Though BSE might have lost substantial market share to NSE in the securities transaction business, our contention is that in the Listing Fee segment, BSE holds about 50% market share and this business segment is expected to grow much faster in the near future. We expect this segment to remain a solid growth area considering the possibility of several hundreds of companies getting listed on the exchanges over the next decade.

In the last 10 years, the overall BSE market cap has more than tripled from around Rs.61 lakh crore in 2010 to over Rs.188 lakh crore at the close of 2020. This solid rise has happened both through organic (existing stocks growing their market caps) and new listing route. Last 10 years saw big ticket IPOs like HDFC Life, HDFC AMC, Avenue Supermarket, SBI Cards, ICICI Prudential Life etc accounting for several lakh of crore of rupees. On the other hand, we also saw a huge number of IPOs from the small and mid cap space and also from the PSU segment. Since a large number of promoters of listed companies have created huge wealth post-listing of their stocks on the exchanges in the recent years, we can expect a large number of privately held companies opting for listing in the next five years. Many more PSUs including LIC would be listed in the next few years as the central government's balance sheet is under stress due to the ongoing Covid pandemic. **This would enable BSE to maintain a solid growth momentum in the revenues from the Listing Fee segment and also make the dependence on the Securities Transaction segment quite insignificant in the next 3 to 5 years.**

Rewards to the Shareholders by BSE is quite Impressive

Within four years of its listing, BSE has completed 2 buyback programs at a total outlay of Rs.626 crore - first at a cost of Rs.166 crore at an average price of Rs.822 per share and the latest at Rs.680 per equity share via tender route at a cost of Rs.460 crore. The latest buyback was for 13% of its equity which is substantial in terms of magnitude. These **buybacks have been highly EPS accretive.** Despite committing a huge outlay on buyback, BSE paid a dividend of Rs.17/ per share for FY2020 which gives a decent dividend yield of 2.7% at the current market price. High dividend payout in the future is likely to continue as the last buyback program led to over 13% reduction in the equity capital.

Diversified Income Stream, minimizing the risk from NSE Competition

Our point is that BSE may have a lower market share in the Equity Transaction business, but it draws substantial revenues from Listing, Investments and also earning quite a significant amount from Data Dissemination (Rs.32 crore in FY2020).

Sr No	Contribution of Segments (FY2020 Consolidated)	Rs. Crore	% of Total Revenue
1	Securities Services (Includes Equity Transaction Charges)	168	27%
2	Services to Corporate (Includes Listing Fees)	212	34%
3	Data Dissemination Fees	32	5%
4	Training Institute	22	3%
5	Sale of Software Licenses, Development, Customization & Maintenance of Software's	16	3%
6	Investment Income	159	25%
7	Other Income	21	3%
	Total	630	100%

Source: Company, Equinomics Research

Collectively the subsidiaries and joint ventures of BSE do not contribute to the profits at consolidated levels as most of them are in nurturing space. Its largest investments are in newly promoted Indian International Exchange (India INX), which is building its business at impressive growth.

BSE-promoted Indian International Exchange (India INX) enjoys ~79% market share overall

- INX will be the next big opportunity for BSE as it operates the first international exchange from India at International Financial Service Centre, Gujarat International Finance Tech City. The Exchange achieved the highest daily trading turnover of Rs. 96,000 crore approximately at its derivative segment in a daily trading turnover on December 28, 2020, with a market share of 84% in GIFT IFSC. The exchange provides a common platform for all asset classes - equities, currencies and commodities. India INX is one of the world's most advanced technology platforms with a turn-around time of 4 microseconds and operates for 22 hours a day to allow international investors to trade from anywhere across the globe. INX has maintained its leadership as the No. 1 exchange in IFSC GIFT City. The exchange provides a competitive advantage in terms of tax structure and a supportive regulatory framework. These include benefits in security transaction tax, commodity transaction tax, dividend distribution tax, and long-term capital gain tax waivers and no income tax;
- BSE has invested Rs.205 crore in INX and International Clearing Corporation and reportedly it is looking to invest an additional Rs.400 over the next three years (including a net worth requirement of Rs.300 crore);

Listing of NSE stock on BSE is likely to be positive development for BSE

Very interestingly, NSE, according to media reports, is being valued at Rs.54,000 crore and it is expected to be listed on BSE in 2021. Around Rs.13,500 crore worth of equity can come into trading on BSE Exchange if NSE dilutes ~25% of its equity on the listing. The kind of transaction volume this Rs.13,500 crore worth of floating stock of NSE can generate could be worth the combined value of several hundreds of the small and midcap stocks being traded on BSE at present. A sensitivity analysis of a leader in the retail business being traded on NSE gives very interesting insight. This leader in the retail business sees an average trading value of around Rs.120 crore per day and on annualized basis it is over Rs.30,000 crore in the cash segment which is 67% its floating market cap of around Rs.45,000 crore. If we assume that NSE, a leader in the exchange business, has a floating market cap of around Rs.13,500 crore and its trading volume in the cash segment in a year is similar to the retail leader, then the possible total trading value of NSE stock alone on BSE exchange per year could be close to Rs.10,000 crore. In our view, this would be a stepping stone to improve the transaction volume on BSE. Most importantly, we believe that BSE's valuation multiple could improve at the time of listing of NSE on BSE.

Valuation and Outlook

BSE is sitting on huge cash and rich investment in CDSL, which combined together account for 113% of the current market cap of BSE. Thus, huge cash and rich investment in CDSL, impressive rewards to the investors in terms of dividends and buybacks, operating in the ever-growing stock exchange business, well-positioned in a duopoly market structure (dominated by just two players) and now aggressively diversifying into many new businesses give us enormous confidence in the BSE stock. Apart from possible listing NSE exclusively on BSE, we expect a huge number of new companies getting listed on BSE in the next 3 years which augur well for BSE. In our view, the long term prospects for the Indian equity markets look very impressive as over \$13 trillion of global stimulus announced consequent to Covid pandemic would ultimately lead to huge foreign capital inflows into the Indian equity markets. We firmly believe that the valuation of BSE stock will get re-rated once NSE gets listed on BSE exclusively and also new ventures of BSE start contributing to the bottom-line. **Hence, we initiate our BUY recommendation on BSE with a target price of Rs.1,000/- (with 12-18 months investment horizon) which is ~21x its FY2022E EPS of Rs.48.**

Key Risks

Any possible massive crash in the stock market due to failure of Covid vaccine or on account of the global economy falling into severe deflationary conditions would be major risk factor for the BSE stock. Also any possibility of NSE stock not getting listed exclusively on BSE would the valuation multiple of BSE.

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BSE Ltd: Risk Profile and Investment Horizon

Stock Risk Profile	Low	Moderate	High	Very High
		✓		
Investment Horizon	1 Year	1-2 years	2-3 years	3 years & Above
		✓		

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	G.Chokkalingam & Family	Equinomics Research & Advisory Private Ltd.	Analyst (Author)
BSE Ltd	NO	NO	NO

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