Why TMX Group (TSX:X) Jumped 12% This Week

Description

It seems odd that in a week where the global stock markets plummeted and political tensions hit a fever pitch, the owner and manager of Canada's flagship stock exchanges saw a spurt in market value.

TMX Group (TSX:X) shares were trading 12% higher today than the same time last week, even as the **S&P/Toronto Stock Exchange Composite Index** stayed flat.

The spike in value can be attributed to the company's better than expected earnings this quarter. TMX reported higher revenue and lower costs in the second quarter of 2019 on Thursday, which beat the expectations of many analysts and investors. Now, the group is expected to expand its dividend payout .

This market-beating performance should come as no surprise to long-term TMX shareholders. The stock has nearly tripled since the start of 2016, while the broader market is up only 36% since then.

I believe this phenomenal pace of growth is powered by three underlying elements of the TMX strategy:

International diversification

The group has been steadily expanding its global footprint since 2015. Now, one third of the company's revenue is generated outside Canada, over half of which is recurring revenue with long-term contracts. Management expects this proportion of international sales to grow over time.

The successful diversification of the business model makes TMX more robust and less tethered to the domestic economy. Investors can expect the recurring income from Europe and Asia to offset any downturn in the North American economy in the near-term, which should limit the downside for shareholders.

Focus on technology

TMX isn't just expanding geographically, but also operationally. The group's efforts to modernize its platform is the driving force of its efficiency and steadily decreasing costs. Meanwhile, the company's

Global Solutions, Insights and Analytics is its fastest growing business segment.

Selling data and analytical tools to corporate clients from across the world is a lucrative business. In 2018, the segment's operating margin was reported at nearly 60%.

However, TMX's hunt for innovation isn't limited to efficiency and data, it also includes blockchain technology. Last year, the group announced its intention to launch a cryptocurrency trading and custodian service platform for clients.

This new venture could be immensely lucrative if cryptocurrency trading becomes mainstream, while the asset-light nature of crypto platforms means the downside is limited if it fails.

A natural monopoly

Finally, the most attractive aspect of TMX's business model is its natural monopoly. Stock markets are highly regulated and systemically ingrained entities that are usually limited to one player.

The **Intercontinental Exchange** (ICE), for example, is the sole operator of the **New York Stock Exchange** and a number of clearing houses that spread from Singapore to London.

Similarly, most of Canada's mainstream capital markets, including the **Toronto Stock Exchange**, **TSX Venture Exchange**, the **TSX Alpha Exchange**, and the **Montréal Exchange,** are all owned by the TMX Group.

This favourable position leads to robust margins and substantial cash flows. It's the driving force behind the company's consistently high dividend payout.

At the moment, the stock offers a 2.2% dividend yield. However, investors can expect this rate to steadily climb up to the company's five-year average of 2.87%.

Bottom line

TMX Group's better-than-expected earnings led to a spike in its market value this week. However, its global footprint, focus on technology, and natural monopoly may imply that the growth spurt is far from over.

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