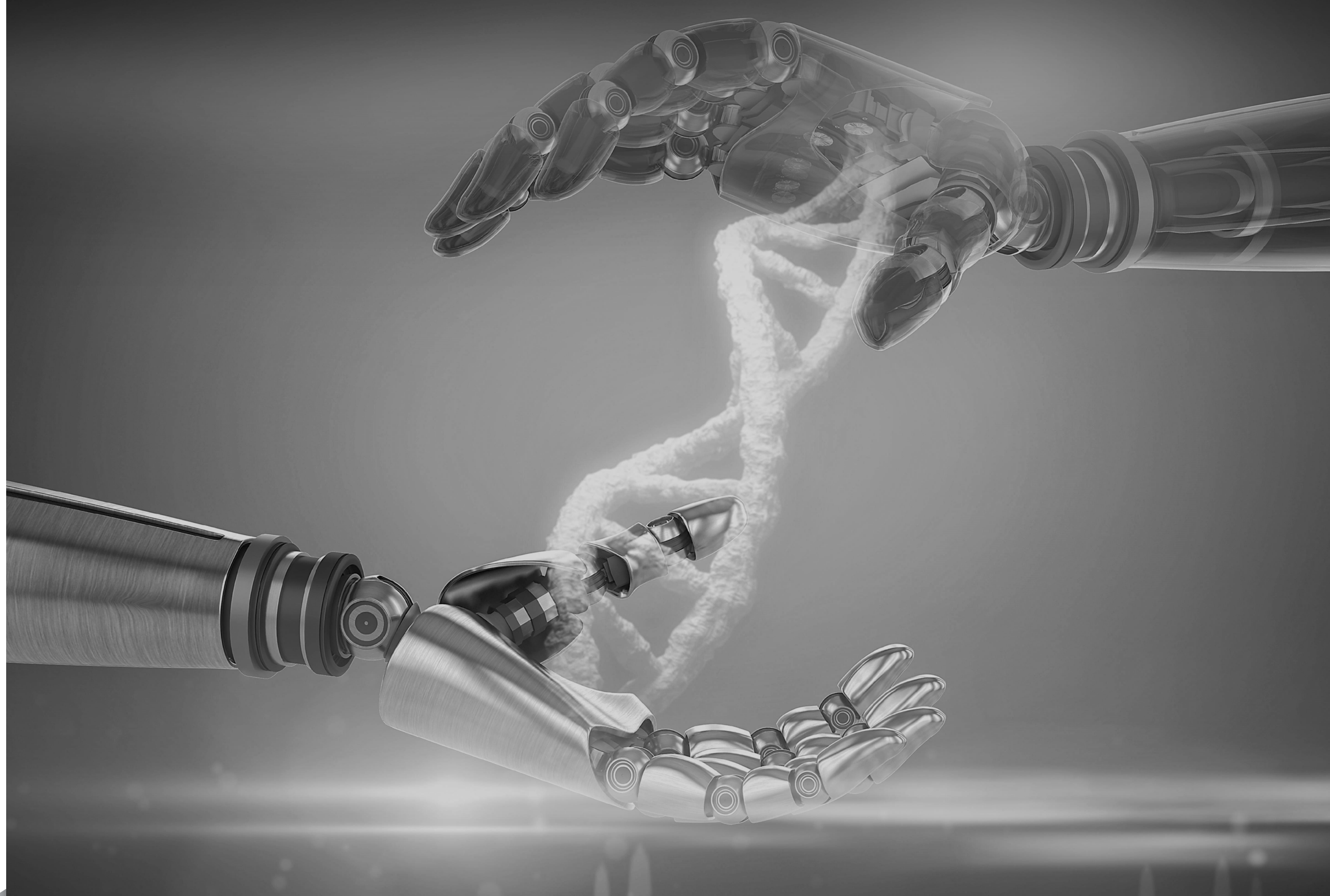
STOCKS DOWN UNDER

29 MARCH 2022

Emerging Stocks Down Under

> *Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas.*

- Paul Samuelson (1915-2009), American economist & Nobel Prize winner



OFX

Better forex services at a better price

Stocks Down Under rating: ★★★★

ASX: OFX
Market cap: A$582.0M

52-week range: A$1.10 / A$2.60
Share price: A$2.33

We accept that foreign exchange (forex) is not the most exciting area in the payments space with the rise of BNPL and cryptocurrencies. But forex is an important service and OFX is a company that does it and does it well. Since listing in 2013, it hasn't had the smoothest tenure on the ASX, but it has performed well in recent months, and we think it is well placed for further growth in the months and years ahead.

Share price chart

Source: Tradingview

The company's business model is simple: Transferring money from one country to another. OFX will calculate the amount to be transferred to the account and transfer the funds, receiving them into its bank account in country A. Then its correspondent bank in country B will transfer those funds to the client's bank account – minus its own fee.

Historically this was charged as a percentage of the transaction and was 0.5%, whereas larger institutions charged more. But now it's a flat $15 fee if under A$10,000, but no fee if it's above that amount. OFX also makes money by taking a forex spread on each acquisition – the difference between the rate quoted by OFX to its client and the cost for OFX to acquire the currency.

Clients can be consumers or businesses and the reasons for transfers are endless, from transferring money between family members or purchasing a vintage car or villa in another country. These can be one-off transfers, regular transfers or in some instances OFX's software is integrated into a business' own software to make transfers seamless. One of OFX's most notable clients in the latter respect is logistics software giant WiseTech (ASX: WTC).

OFX was founded in 1998 by Matthew Gilmour and Gary Lord from the former's house at Sydney's Northern Beaches. The pair thought consumers needing foreign exchange services could get better service at a better price. From those humble beginnings, it was a slow and steady journey, but by the time it listed in 2013 at $2 per share, it generated $1bn in turnover and had a presence in several markets globally – in Australia, the UK, Canada, the United States, Europe and the Asia-Pacific. Unfortunately, there were tough times in the first few years with disappointing results, the loss of a partnership with Westpac and takeover interest from Western Union (at $3.70 a share) ultimately falling through.

A shift from B2C to B2B that paid off

But things have been better for OFX since it hired John Alexander ('Skander') Malcolm as CEO and pivoted from consumers to business – a segment that generates more recurring revenue. Typically, consumers only need forex services every now and again, but businesses that need forex services will need them regularly. Clients want competitive pricing, high standards of security, the ability to manage volatility risk of forex exposure and the ability to speak to a human being when things go wrong (not a chatbot) and OFX provides this enhanced service.

This approach has paid off. The company has recently surpassed $3bn in monthly turnover and is expecting a record year of EBITDA, tipping $43m - $45m at its investor briefing held earlier this month – which would be up 41% - 48% on FY21. OFX is performing well despite challenging industry conditions with the pandemic, high levels of competition, the rise of eCommerce in cross-border payments and increased regulatory scrutiny (the forex space is vulnerable to AML/CTF breaches).

Still room for growth

Consensus estimates agree with OFX's FY22 guidance, tipping $44.2m in EBITDA plus $157.2m in revenue. In FY23, consensus estimates call for $58.9m in EBITDA and $220m in revenue. These numbers imply very respectable EBITDA growth of 33% and revenue growth of 40% respectively.

We won't have to wait long to see if the FY22 figures eventuate given OFX's financial year is 1 April to 31 March. The company will consequently report results in mid to late May. It is trading at an EV/EBITDA of 9x and a P/E of 20.8x for FY23. So, from a valuation to growth perspective, we believe OFX is looking very interesting with an EV/EBITDA-to-EBITDA-growth ratio of just 0.27.

We would also note OFX has six fund managers as substantial holders including (but not limited to) Pendal, Australian Ethical and Ellertson Capital – depicting strong investor confidence in the company.

OFX is not the cheapest ASX company by any means, but we believe it deserves a premium and has further room for growth. OFX is not just a neo bank or BNPL company that's done nothing except cheesy marketing campaigns telling people how bad their bank or credit card provider is (which Blind Freddy could've done). It provides a critical service to business and is led by management that have built up a positive culture and service standards and are committed to growing the business.

Well positioned to capitalise

OFX has a healthy, debt-free balance sheet with over $40m in cash for its own use, plus $236m held for subsequent settlement of client liabilities. We are also excited by its recent acquisition of Canadian forex business Firma, which will complete in April. This will increase its B2B revenue share from 52% to 65% and its cash flow from operating activities from $38.7m to ~$47m.

Yet, it still only has a very small market share of <0.05% of the global cross-border payments revenue. It is highly unlikely it will substantially dent the 72% share held by banks and incumbents, but it is far better positioned than its peers to increase its market share, particularly among smaller providers that target SMEs rather than large corporates. All things considered, it's four stars from us.

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