



ASX Small Caps Stocks Down Under

📖 *The first of April is the day we remember what we are the other 364 days of the year.* 🗨️

- Mark Twain (1835 - 1910), American writer

BEFOREPAY GROUP

Set to bounce back

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Stocks Down Under rating: ★★☆☆

ASX: B4P
Market cap: A\$28.0M

52-week range: A\$0.82 / A\$2.51
Share price: A\$0.85

Yes, we all know the Beforepay IPO was horrible. The payday lender raised \$35m at \$3.41 a share but ended its first day on 17 January 2022 at only \$1.905. It has since been as low as 83 cents. However, the recent on-market purchase of stock by Chairman Brian Hartzler, directors Daniel Moss, Stefan Urosevic and notable pre-IPO investor Alium Capital, along with its recent 1HY22 results, suggest that better times may be ahead for Beforepay.

Share price chart



Source: Tradingview

Beforepay is building a sizeable business out of providing people with their pay before they receive it from their employer, a service known as payday lending. This company is not the only firm in this space, but it does business in a technologically advanced way, offering the Beforepay service through mobile and browser applications. And they do it ethically, charging a fixed fee equivalent to 5% of the cash out, but not charging interest or late fees.

The average Beforepay customer borrows for less than 20 days and most customers are young, with the average customer age being only 33. And those Millennials and Gen Zs clearly like the Beforepay offering. This company was only founded in 2019, but by the time it went public in January it had reached 139,000 active users. Just a year earlier it was only 46,846.

So, why did investors turn against Beforepay so savagely at listing? Well, the deal was priced in November 2021, when the markets were strong, but the stock was listed in January 2022 when markets were weak.

A big opportunity

Beforepay believes it is serving a huge potential market – the 5.3m Aussies who have no savings and therefore sometimes face difficulties with sudden everyday expenses. Many are ineligible for bank overdrafts and even if they are, these aren't convenient or easy to use. Not everyone qualifies to be a Beforepay customer,

mind you – you need to have at least \$300 per week in income, have a regular pay schedule and have at least 50% of your income from an employer. Until April 2021, Beforepay allowed people with over 50% of their income as government benefits, but it has changed that policy.

Beforepay is a more accessible alternative to high-interest-rate credit cards. Although the use of credit cards in Australia is declining, there were still 16.2m in circulation in 2021. Buy Now Pay Later (BNPL) services have been a beneficiary of the desire for finance without interest rates and, curiously, over 60% of Beforepay customers also use BNPL. Beforepay says it is different, but complementary to BNPL because BNPL isn't available at all retailers and for all expenses.

Less defaults, more margin

One of the things that has investors worried about Beforepay is default rates, but the company thinks it has this under control, bringing it down from 7% in December 2020 to 3% by October 2021. Importantly, Beforepay's net transaction margin, which is lending revenue minus funding costs, write-offs and platform expenses, has moved into the black. For the six months to December 2021 that margin was \$0.36m on about \$6m in Beforepay revenue. That tells you that the algorithms which help Beforepay assess credit risk and screen out the non-payers are working well.

The thing we really like about Beforepay is the speed of growth. In the December 2021 quarter there was \$77m in pay advances issues, which was 361% more than in the December 2020 quarter. Part of that increase simply resulted from an increase in the number of customers, while another part of the increase was due to the increasing average size of advances, from \$125 to \$260.

As word gets around about the Beforepay offering, we think there'll be more growth where that came from. The trouble with Beforepay is that profitability will take a while. The 1HY22 EBITDA loss was \$11.2m (excluding fair value adjustments and one-off IPO costs) and consensus has this company getting to FY24 and still being down by \$7m at the EBITDA line. Revenue, however, is expected to rise a lot over the next couple of years. On consensus it'll go from \$15.7m this year to \$30m in FY23 and \$46m in FY24. And the company is well funded for that growth. It ended December 2021 with \$37.6m in the bank.

Regulators

One concern some investors have is that regulators might not be kind to Beforepay between now and 2024. Consumer lenders usually must have an Australian Credit License (ACL) and abide by the National Credit Code (NCC). Beforepay is currently exempt, since its model represents a form of short-term credit, where fees and charges do not exceed 5% of the amount of credit, the term is under 62 days and where no interest is charged.

While ASIC has talked big but done little in relation to BNPL companies up to this point, the Beforepay naysayers fear things could be different for this company. In ASIC's Corporate Plan for 2021-25, one of its highest strategic priorities for 2021-25 was "review[ing] continuing credit models and other models purporting to be exempt from the National Credit Act". If Beforepay had to obtain an ACL it would have to go through a formal application process, which would likely be lengthy.

Nevertheless, for investors with risk appetite we think Beforepay may be good buying right now. There are about 46 million shares on issue, so cash backing as of December 2021 was about 81 cents. You might say at yesterday's closing price of 85 cents you were buying the emerging Beforepay business nearly for free. No wonder cornerstone investor Alium Capital has increased its holdings from 6% to 9.5% since the company listed. Chairman Brian Hartzler and his two boardroom colleagues Daniel Moss and Stefan Urosevic were also recent on-market buyers. For investors comfortable with the regulatory risk, we noted above and comfortable with the fact that profitability is a while away yet, this one is four stars.

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