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# Undervalued financial services stock is on a roll

TIM SHUFELT - INVESTMENT REPORTER
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The market has awoken to the growth potential ahead of Currency Exchange International (CXI) Corp., driving up the stock by almost 50 per cent in little more than a month. That rally, which has lifted the share price to the $22 range, captures just a portion of the company's prospects, said Jerome Hass, a portfolio manager at Lightwater Partners, which owns shares of the company, a provider of foreign currency services to financial institutions.

"It's a low-risk, high-growth business, and I think it has the potential to be something very big," Mr. Hass said. "We have no problem saying this will hit $30 in the short term."

CXI is poised to benefit from a number of catalysts, including the possible approval of a Canadian bank licence. "Once that banking licence kicks in it certainly opens up many more doors for them," Mr. Hass said.

CXI has only been listed on the Toronto Stock Exchange since 2012, but its previous incarnation was born almost 30 years ago. Chief executive Randolph Pinna established the business, then called Foreign Currency Exchange Corp., targeting both wholesale and retail clients of foreign currency in Canada and the United States. A Bank of Ireland subsidiary acquired the company in 2003. Five years later, Mr. Pinna re-entered the market when he bought back a handful of U.S. retail stores from Bank of Ireland.

"He's been there, done it, and is doing it again," Mr. Hass said.

CXI's revenues comprise the spread between the cost and selling price of foreign currency products, Industrial Alliance analyst Dylan Steuart said in a recent note, initiating coverage of the stock with a "strong buy" recommendation and a $28 price target. The two other analysts covering the stock also rate the stock a "buy" at an average target price of $27.50.

Demand for foreign exchange is mainly driven by global tourism. While non-cash payment systems continue to gain traction in domestic transactions, travellers still prefer cash, according to data provided by Travelex, Mr. Steuart said. "The firm estimates that the cash market will continue to grow at a healthy 6 per cent per year from 2013 to 2018."

Within that market, CXI is poised to make its greatest advances with wholesale clients, including banks and credit unions. The retail stream consists of 30 U.S. branches, a segment that is expected to account for only about 13 per cent of CXI's foreign exchange flows in the 2014 fiscal year, Mr. Steuart said. Bank of America dominates the North American foreign exchange services market; CXI can gain market share as a result of Mr. Pinna's relationships and reputation, as well as its superior software offering, according to Mr. Hass.

While estimates for the company's organic revenue growth sit at about 30 per cent a year in the coming years, Mr. Hass thinks that target can be easily beaten, especially if the Office of the Superintendent of Financial Institutions approves CXI's application to operate a wholly owned subsidiary as a Schedule 1 Canadian bank. Most of the Big Six banks have self-imposed restrictions preventing them from dealing with non-banks providing foreign exchange. The legitimacy of a banking licence could greatly expand CXI's pool of potential clients both in Canada and the U.S.

But approval is not guaranteed. "While timing for bank licence approval is difficult to predict, we are approaching two years since the application was filed with OSFI, which would lead us to expect approval in the near term," Mr. Steuart said.

Even after the recent stock run, CXI is undervalued compared with its peers, trading at an enterprise value of about 10.1 times estimated 2015 earnings before interest, taxes, depreciation and amortization, while the peer average sits at about 12.5, Mr. Steuart said.

He said he thinks CXI should actually trade at a premium based on its superior growth prospects and margins, as well as its clean balance sheet.

Meanwhile, CXI is likely to be a good takeover candidate at some point, as it was the last time around, said Michael Smedley, chief investment officer at Morgan Meighen & Associates, which owns shares of CXI. Mr. Smedley also sat on the board of the company when it was private.

"At some stage, the inevitability occurs, for the second time, that some other larger financial institution will take it out," he said.