Currency Exchange International (CXI) – an exceptional investment opportunity

By Ian McLean
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- Price in March 2023: $18 - $19 US
- Plausible scenario for price in 2029: $50 US + (+17-18% per year)

Currency Exchange International (CXI) provides currency conversion services. They do business with a diverse customer base of individuals, businesses and banks and offer their services through physical locations and on the internet.

They have two divisions: physical banknotes and payment services (for example to make an electronic payment from a Canadian dollar account to a US dollar account).

CXI is a growing company. Before the pandemic, the company had achieved an average growth of 22% per year since becoming a public company in 2012. The pandemic put a damper on this growth, but it is now back. Full-year 2022 sales were 59% above 2019 sales. Travelers are back and the payments division is continuing its strong growth (+66% in 2022).

Senior management owns 28% of the shares, the majority of which is held by the founder, Randolph Pinna, an exceptional CEO, passionate about CXI and its growth. Randolph is highly respected in the industry and is very focused on providing quality customer service. Incentives are very well aligned with shareholders at Currency Exchange International.

We started buying shares of CXI in early December 2022 at a price around US$13.75. At this price, CXI stock was selling for approximately 6X its net earnings (market value of approximately $89M US). As of October 31, 2022, CXI had US$92M in cash, a US$28M line of credit and no long-term debt; which gave it a net cash balance of $64M US.

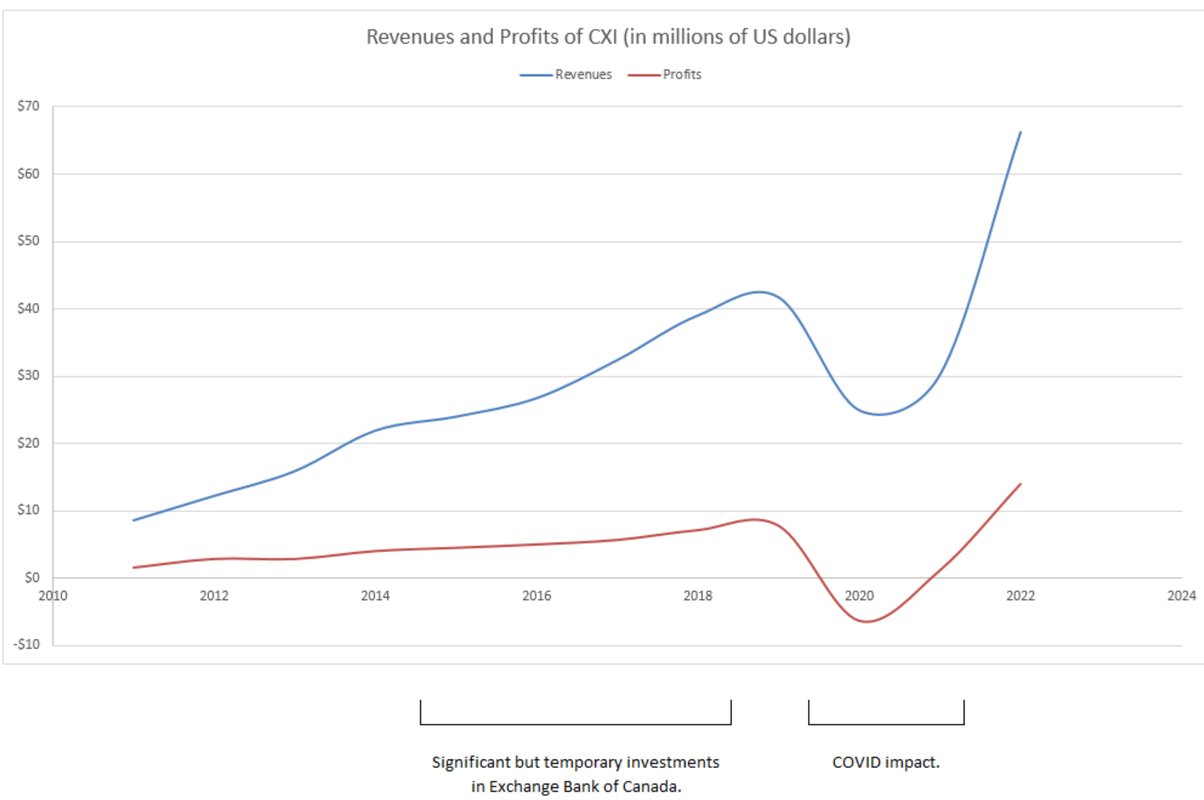
What explains this situation?

1. Small "under-the-radar" public company.

2. Company listed in Canada, a stock exchange less followed than those in the United States.

3. Very affected by the pandemic / exposure to travel comeback.

4. The explosive growing payments segment has only recently become apparent on the books.



Banknotes – 79% of sales in the 1st quarter of 2023

Banknotes includes the physical currency trading for retail and institutional clients. The revenues of this segment are mainly generated by exchange rate differences.

The retail division includes 38 exchange kiosks (as of January 31, 2023) in high traffic tourist destinations, Online FX (online banknote ordering) and airport locations on a franchise basis. CXI also has 4 vaults (including one temporarily closed) and 797 consignment locations where currency is kept on consignment.

On the institutional client side, CXI offers the following services to banks and similar institutions:

1. Sale of banknotes in various currencies for institutions that have their own safes and have their own currency services.

2. Full service for small/medium sized financial firms that outsource FX requirements (for various regulatory reasons) and buy/sell FX directly from CXI - these clients buy at lower volumes but offer higher margins.

One of CXI's competitive advantages is that it is not a direct competitor to other banks, so many small and medium-sized banks tend to choose CXI instead of partnering with banks like Bank of America.

The Currency Exchange also owns a Canadian Schedule 1 bank called The Exchange Bank of Canada. This bank is one of the few institutions that is part of the FBICS program (Foreign Bank International Cash Services) of the Federal Reserve of the United States. This allows them to order new banknotes directly from the Federal Reserve without going through an intermediary. This ability to obtain banknotes without paying an intermediary is quite exceptional and a major competitive advantage for CXI.

As of January 31, 2023, CXI did business with 2,681 institutions and 16,567 institutional locations.

In the banknotes division, sales are seasonal and driven mainly by tourist traffic. The business has been hit hard during the pandemic. Prior to COVID, the company, which was primarily a banknote business at the time, generated profits of US$7-8 million per year.

There are several interesting aspects here, which indicate that when the number of international travelers recovers (which is already done in early 2023), the business should not only return to pre-COVID levels, but most likely exceed the historical numbers:

1. Despite a *possible* gradual decline in the use of banknotes, the company is firmly established and steadily increased its market share before COVID. Despite the move towards electronic payment options, there is a large global banknote market. Many traditional banknote providers are not investing in or exiting the business, at a time when banks around the world are outsourcing the handling of foreign notes. This bodes well for CXI.

2. The pandemic has further improved CXI's competitive positioning as a major competitor (TraveleX) exited the North American market in April 2020 due to liquidity issues. TraveleX generated approximately $100 million in revenue in North America before the pandemic. Most of its customers were credit unions (institutional) and airports (retail). Post-exit, CXI was able to pick up many of TraveleX's institutional customers and is also targeting airport locations that TraveleX left through a franchise structure. The company is already open at JFK, Chicago O'Hare and Chicago Midway. Revenues for CXI at airports are very high. With all this, the company has already expanded its number of relationships with institutions by +22% compared to pre-COVID. This indicates a significantly larger business base and suggests improved revenue once international normalizes. Here is a quote from Randolph Pinna during the Q2 2021 conference call:

   "Despite the COVID we continue to add a lot of customers. Partly this has been fueled by our larger competitor, a company based overseas that has fell down during the pandemic. They have recapitalized their business, but the caveat with the finance was they exited the America (US, Canada and Carribean). That has helped fuel additional customer growth, which is gonna be very good once the world finally reopens."

3. CXI intends to expand the banknote business globally stating that after the departure/shrinking of several international competitors (HSBC, Bank of Ireland, TraveleX), a global player is necessary. The main catalyst for this is the FBICS – as I mentioned, the company is now part of the US Federal Reserve's FBICS (Foreign Bank International Cash Services) program. This virtually eliminated the company's supply costs, as it previously had to source currency from another bank paying a significant fee, put those banknotes in its own vaults, process them, and send them. Now, CXI will

be able to obtain foreign exchange directly from central banks with same-day delivery. This translates into significant annual cost savings. Moreover, such Fed approval has translated into increased credibility and the ability to source new banknotes for which there is strong global demand. The company intends to attract new international customers with larger volumes.

4. In the fourth quarter of 2019, CXI acquired Texas-based eZforex.com, which provided foreign exchange services to 236 financial institutions. It's likely that eZforex's potential results weren't reflected in CXI's performance during the pandemic, but likely will be now as travel recovers.

5. The company has implemented significant cost reduction efforts during the pandemic. Profitability in 2022 was higher than before the pandemic. It is quite possible that operating leverage will now be permanently higher as a result of efficiency gains.

At the end of March 2023, the market value was now US$121M. The division of banknotes alone can justify this assessment. We haven't even considered the payments division, which is growing rapidly, and the fact that CXI had US$100M in cash as of January 31, 2023.

Payments – 21% of sales in the 1st quarter of 2023

The payments division is growing strongly. CXI focuses on small and medium sized businesses which are generally less of a priority for large banking institutions.

For companies that buy commodities in foreign currencies such as US dollars, CXI offers an online platform, high quality service and competitive prices on inter-currency transfers/payments.

The payments industry is relatively new to the company. It is based on proprietary software created by CXI called CEIFX which allows clients to process international payments, foreign banknotes and foreign checks on the same platform.

The software also provides the tools for clients to comply with US and Canadian foreign exchange trading regulations.

The CEO pointed out that a "secret sauce" of their software is that it compiles live data, whereas most other competitors do it the next day. This reduces the risk that transaction limits were exceeded the day before.

The payments sector is not exposed to seasonality or the resumption of travel.

Here are some interesting things about the payments split:

1. A major recent growth catalyst has been the integration of CEIFX into the Fiserv Fedwire platform in July 2019. Fiserv is the largest provider of basic banking software in the United States with a market share of 37% (in 2022).

2. Another catalyst is the integration of the second core software provider - Jack Henry (16% market share in 2022).

3. In July 2020, CXI acquired its Canadian payment counterpart Denarius, expanding the sales team and also adding 450 new corporate clients in Canada.

Payment software generated US$12.4 million in revenue in 2022. Customers are apparently pretty sticky. Given the new platform integrations and expanded sales team, the current growth is expected to continue for the foreseeable future. Although the profitability of the segment is not disclosed, it is a highly attractive software business that is expected to generate significant operating margins at scale. If the current growth continues over the next 2-3 years, the payments segment alone could reach an operating profit of $5-10 million. Today, investors pay nothing for this option.

Conclusion

CXI's appeal stems from its strong profitability, high growth potential, exceptional management team and bargain valuation.

CXI focuses on a specific, smaller customer base, which is not prioritized by competitors such as Bank of America and Wells Fargo. Additionally, the void left by TraveleX has created significant growth opportunities for CXI.

The Exchange Bank of Canada is one of the few institutions that is part of the FBICS program. This ability to obtain banknotes without paying an intermediary is quite exceptional, a major competitive advantage for CXI and brings significant growth potential.

Invested alongside us as our first shareholder, founder and CEO Randolph Pinna, whom I had the chance to speak to by video call more than once, is an exceptional and passionate individual.

I continue to study our investment in Currency Exchange International. To date, I have not found a flaw and even on the contrary, my conviction is becoming stronger and stronger.

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