# LVS ADVISORY

**Recommendation:** Long MoneyGram International (NASDAQ:MGI)

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## Summarized Investment Thesis

MoneyGram is a peer-to-peer cross-border money transfer business. The stock is under-followed and the business is perceived to be secularly challenged when in fact it has a rapidly growing digital business that would be worth multiple times the total market cap if it were valued similarly to peer VC-backed unicorns.

MoneyGram has near-term regulatory and financial catalysts that will enable it to re-shape its capital structure and immediately accrete more than 50% to cash flow generation. The company is heavily investing around its digital business which has superior unit economics and will result in an upgrade in business quality over time. The company's digital business is growing at a healthy double-digit rate and is expected to represent the majority of sales and earnings within the next 3 years.

Currently trading for 7.4x forward EBITDA, MoneyGram is under-valued even when compared to its legacy money transfer peers. However, the stock has the potential to trade at a significantly higher valuation multiple when the market recognizes the quality of its FinTech assets. Our base case assumption is an equity IRR of 30% over the next 5 years, and our bull case assumption is an equity IRR exceeding 50%.

In short, investing in MoneyGram stock is an extremely asymmetric proposition today. The company is under-valued, under-followed, and on the cusp of increasing its earnings & cash flow by simply re-financing its capital structure (expected in July 2021). The company has faced numerous headwinds (company-specific and macroeconomic) which have all turned into tailwinds. Finally, there is significant upside opportunity as the company continues to rapidly grow its digital business and receives recognition from investors of the improved business quality and long-term earnings growth prospects.

## MoneyGram Overview

MoneyGram®

MoneyGram is a global cross-border money transfer business. The company is a unique and hard to replicate financial network with a globally known brand developed over the past 30 years. It is the second largest peer-to-peer cross-border payments company after Western Union, and in addition to Ria (owned by Euronet Worldwide), is one of three players with a global scale retail agent footprint. The company operates in 200 countries and has over 410,000 agent locations.

The company primarily makes money by charging fees in order to facilitate sending/receiving money to/from people all over the world. Today, the largest contributor is its legacy retail money transfer service which is where customers walk into a physical agent location branded as a MoneyGram franchise in order to send money funded from cash or card. Digital money transfer (also referred to as MoneyGram Online) is where customers initiate a money transfer from the MoneyGram app or website. The company also offers Bill Pay and Money Order services which are business lines in decline but continue to generate a stream of cash flow. Finally, MoneyGram generates investment income from reinvesting the float from money orders; investment income is now de minimis due to the low interest rate environment but will return if rates go up.

| Sales Mix | 2019 | 2020 | LTM |
|---|---|---|---|
| Retail Money Transfer | $1,009 | $917 | $920 |
| Digital Money Transfer | $115 | $188 | $214 |
| Bill Pay | $59 | $46 | $44 |
| Money Orders | $47 | $46 | $47 |
| Investment Income | $55 | $20 | $12 |
| Total Revenue | $1,285 | $1,217 | $1,236 |

| Sales Mix | 2019 | 2020 | LTM |
|---|---|---|---|
| Retail Money Transfer | 79% | 75% | 74% |
| Digital Money Transfer | 9% | 15% | 17% |
| Bill Pay | 5% | 4% | 4% |
| Money Orders | 4% | 4% | 4% |
| Investment Income | 4% | 2% | 1% |
| Total Revenue | 100% | 100% | 100% |

Source: MoneyGram financial reports.

MoneyGram's retail money transfer business is mature but it is not in rapid secular decline as many suspect. Western Union provides more detailed disclosures of price/volume and using those metrics as a proxy shows that money transfer volumes have been remarkably consistent over the years but pricing per transaction has steadily declined. We believe pricing will continue to drop for the product and forecast the segment to continue declining at a 9.4% rate in the coming years (the average rate of decline pre-pandemic); however, there could be upside to the extent that the legacy retail money transfer business proves to be more stable. The retail money transfer business line actually comped positive last quarter!

Digital Money Transfer is already priced competitively and is expected to grow in the coming years through greater volume realization. The digital transfer segment is profitable but the company is reinvesting its cash flow in performance marketing to accelerate growth. More on this later.

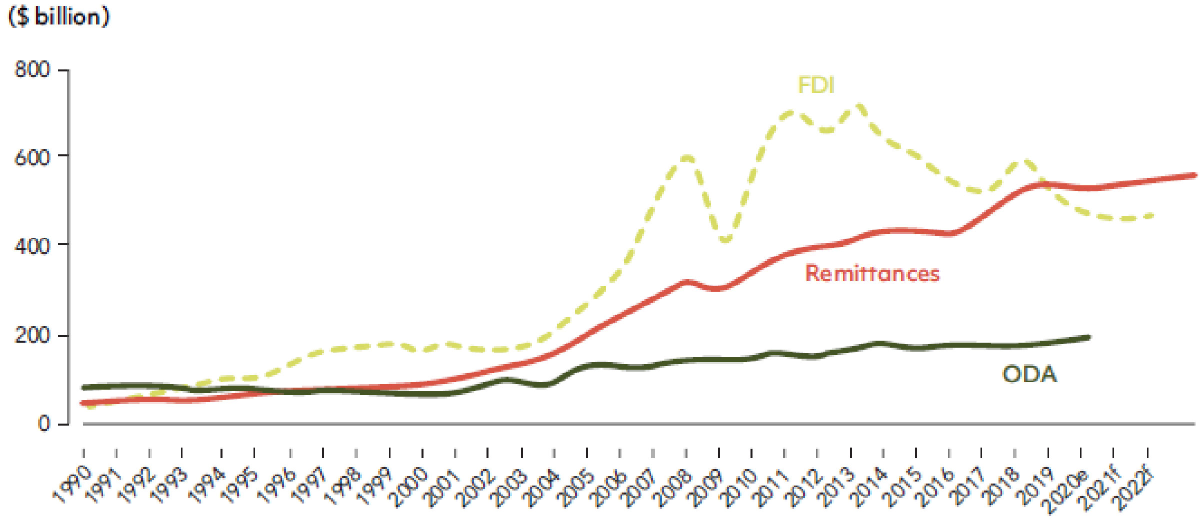
Outside of transaction processing fees, the expense structure is largely fixed and will benefit from operating leverage as revenue grows. To illustrate the point, Western Union operates with a 4x larger revenue base today and has a similar gross profit margin but Western Union's EBIT margin is double MoneyGram's. MoneyGram has all the pieces in place to grow from here, we expect margins to expand and incremental returns on capital to be attractive.

## Remittance Industry Overview

Personal cross-border money transfer or remittance is one of the most significant financial services categories in the world but it is rarely discussed in the investment community because it is not relevant to the lives of most people in developed countries. For migrants and those residing in low-and middle-income countries, remittances represent an important source of income and an important social safety net.

Over $700 billion of remittances are sent annually according to the World Bank. Ex-China, annual remittance volume exceeds both foreign direct investment and foreign government aid. For more than two dozen countries, remittance income accounts for more than 10% of GDP and for several countries, remittances are the single largest contributor to GDP.

**Figure 1.1a** Remittances, Foreign Direct Investment, and Official Development Assistance Flows to Low- and Middle-Income Countries, 1990–2022




*Sources:* World Bank–KNOMAD staff estimates; World Development Indicators; International Monetary Fund (IMF) Balance of Payments Statistics. See appendix in the *Migration and Development Brief 32* for forecasting methods (World Bank 2020c).
*Note:* FDI = foreign direct investment; ODA = official development assistance; e = estimate; f = forecast.

Source: The World Bank.

The United States is the largest remittance 'send country' but there are many other significant transfer corridors including Western Europe to Eastern Europe, the Middle East to South Asia, and Russia to Central Asia, to provide a few examples.

From 2009 to 2019, the global volume of remittances flows increased 66% (5.2% per year) from $433 billion to $719 billion. Global volumes are expected to continue growing at a mid-single-digit rate for the foreseeable future.

The near-term growth outlook is particularly rosy. Migrants have been disproportionally impacted by the shutdown of restaurants, factories, and other low-skill labor jobs. Additionally, in the U.S. immigration was negatively impacted by Trump-era policies. Between 2016 and 2019, legal immigration fell 17%. President Biden has already reversed some of the most punitive immigration policies enacted by President Trump and has proposed several policies that would support/encourage immigration.

## Biden Immigration Policy Tracker

| CATEGORY | NEW BIDEN POLICIES | TRUMP POLICIES REVOKED | TRUMP POLICIES STILL IN EFFECT | TRUMP POLICIES BLOCKED OR NEVER FINALIZED |
|---|---|---|---|---|
| LEGAL IMMIGRATION | 3 | 0 | 1 | 1 |
| HUMANITARIAN | 3 | 2 | 6 | 1 |
| ENTRY BAN | 0 | 4 | 3 | 2 |
| WORK VISAS | 0 | 0 | 10 | 5 |
| SECURITY | 1 | 0 | 1 | 2 |
| PUBLIC CHARGE | 0 | 3 | 0 | 1 |
| RED TAPE | 1 | 2 | 3 | 0 |
| IMMIGRATION FEES | 0 | 0 | 2 | 1 |

Source: boundless.com

The cross-border money transfer industry has significant barriers to entry. Every country requires a money transfer license and there are strict and specific compliance standards due to the need to ID customers and trace funds in order to prevent money laundering and other illicit financial transactions. Furthermore, there are significant operational and logistical challenges involved in operating a global payments network with hundreds of local and regional partners.

Domestic peer-to-peer money transfer services including Venmo and Square do not offer cross-border money transfer due to the regulatory/operational barriers. Additionally, many banks partner with the B2B arm of remittance companies to facilitate cross-border transactions.

There are many operators with a regional focus or a digital-only focus. MoneyGram and Western Union are the only two operators that have a global presence with a strong offering in both retail walk-in and digital channels.

## Regulatory Catalyst

In 2012, MoneyGram reached a settlement with the Department of Justice over an anti-fraud complaint from 2003 to 2009. The settlement involved a deferred prosecution agreement with a 5-year term. The DoJ put MoneyGram's compliance program under monitorship. In 2017, the term was extended. In February 2020, an agreement was reached for MoneyGram to pay a total fine of $125 million. The fine was paid in full May 2021 and in June 2021 the matter was dismissed by a court, ending DoJ monitorship of the company.

The DoJ settlement and monitorship was a dark cloud over the company for nearly 9 years. The regulatory issue made it more difficult for MoneyGram to strike partnership agreements and made it more difficult for the company to make agile decisions because everything was under review from its regulator.

The situation was particularly fraught because MoneyGram's balance sheet was in poor condition following the 2008 financial crisis. In addition to the $125 million fine, MoneyGram spent approximately $100 million in a compliance improvement program and exited the Chinese and Nigerian corridors – two high volume but high compliance risk markets.

With the DPA now behind it, MoneyGram now has a greater ability to control its own destiny. The company has already announced several interesting new partnerships and initiatives. Most notably, MoneyGram has launched a new B2B division where it will power the back-end infrastructure for other companies that want to facilitate cross-border money transfer.

There were also material costs associated with maintaining the DoJ monitorship. In 2019 and 2020, MoneyGram incurred $14 million and $11 million in Direct Monitor Costs. These expenses will go away – although they were still incurred during the first two quarter of 2021 before the matter was dismissed.

## Anticipated Debt Refinance

MoneyGram's regulatory issues have also inflated the company's cost of equity and debt capital.

As of Q1 2021, MoneyGram had $634 million of first lien debt at a 7% interest rate and $255 million of second lien debt at a 13% interest rate. In 2020, the company paid $77.5 million in cash interest expense.

In June, MoneyGram completed an at-the-market equity offering of $100 million and used the proceeds to pay down $100 million of the 2nd lien term loan. On July 14, MoneyGram announced it priced its new issue of senior secured notes at $415 million and that in combination with a re-structured credit facility, it would replace its pre-existing debt. The terms of the new credit facility were not disclosed but the company expects both pieces of the capital structure to be put in place on July 21, 2021.

## MoneyGram's Capital Structure

| | 12/31/2020 | 3/31/2021 | 6/28/2021 | 7/21/2021 |
|---|---|---|---|---|
| Stock Price (7/14/21) | $9.82 | $9.82 | $9.82 | $9.82 |
| Shares Outstanding (front cover) | 72.542 | 79.674 | 90.531 | 90.531 |
| **Market Capitalization** | **$712.4** | **$782.4** | **$889.0** | **$889.0** |
| | | | | |
| Ripple warrants @ $4.10 exp 2029 | 5.958 | 0.000 | 0.000 | 0.000 |
| Employee stock options (anti-dilutive) | 0.278 | 0.269 | 0.269 | 0.269 |
| Restricted stock units (anti-dilutive) | 5.158 | 4.312 | 4.312 | 4.312 |
| Fully diluted shares outstanding | 83.935 | 84.255 | 95.112 | 95.112 |
| **Diluted Market Capitalization** | **$824.2** | **$827.4** | **$934.0** | **$934.0** |
| | | | | |
| Cash & Equivalents | $196.1 | $152.8 | $152.8 | $152.8 |
| 7.00% first lien credit facility due 2023 | $635.3 | $633.7 | $633.7 | $0.0 |
| 13.00% second lien credit facility due 2024 | $254.6 | $254.6 | $154.6 | $0.0 |
| $400m Credit Facilitiy | $0.0 | $0.0 | $0.0 | $373.3 |
| 5.375% Sr. Secured Notes due 2026 | $0.0 | $0.0 | $0.0 | $415.0 |
| Unamortized debt issuance costs | ($32.1) | ($29.5) | ($29.5) | ($29.5) |
| Total Debt | $857.8 | $858.8 | $758.8 | $758.8 |
| Pension Liability | $74.5 | $75.0 | $75.0 | $75.0 |
| **Fully Diluted Enterprise Value** | **$1,560.4** | **$1,608.4** | **$1,615.0** | **$1,615.0** |
| | | | | |
| Net Debt | $661.7 | $706.0 | $606.0 | $606.0 |

Source: MoneyGram financial reports.

We have spoken with the company's CFO, credit analysts familiar with the situation, and one major credit hedge fund that is long MoneyGram's debt. Based on these conversations and the indicated pricing of the debt, we are bullish on the company's new capital structure and prospects to significantly reduce its cash interest expense.

In 2020, MoneyGram's effective interest rate 11.4%. We anticipate that by 2022, the company will be able to more than halve its interest expense from $77.5 million to less than $40 million through a combination of the debt refinance and continued debt pay down.

MoneyGram generated $86 million of adjusted free cash flow over the last twelve months, assuming at least $40 million of interest expense savings from a refinance and $10 million of savings from the removal of direct monitor costs results in an immediate 58% accretion to the company's free cash flow before any incremental free cash flow from organic growth is taken into account. Refinancing to a lower interest rate and reducing the company's debt load should also have a positive impact on the company's cost of equity.

## MoneyGram's Digital Transformation

Despite distraction from regulatory issues, MoneyGram has executed a substantial digital transformation beginning in 2016.

MoneyGram has streamlined its operations as much as possible and re-platformed its IT systems, moving its infrastructure to the cloud. The digital transformation has enabled the company to improve efficiency and also improve the customer experience. For example, implementing its customer support functionality in the cloud enabled local language live chat which has resulted in a nearly 75% decline in call center volume.

MoneyGram has transitioned to using an API-based technology infrastructure and launched MoneyGram Online in 2018. MoneyGram Online is the company's digital product offering which enables customers to send money from their bank account or card either directly to a bank account or to a local agent where a recipient can pick up funds in cash. The ability to send funds digitally and pick up in cash is a key competitive advantage compared to digital-only companies like Wise which only enable digital to digital transfers. Digital-focused remittance companies like Remitly enable digital send with cash pick-up but this functionality is not supported in all corridors and the number of pick up locations is significantly less compared to MoneyGram or Western Union.

The company's digital business has been growing at an extremely rapid rate and is quickly shifting the product mix. MoneyGram's digital business now represents 31% of its money transfer revenue (Q1 2021) and is annualizing at over $250 million in revenue. Management expects digital revenue to exceed retail money transfer revenue by 2024.

MoneyGram's digital transformation represents an upgrade in business quality relative to the retail money transfer business. Enticing customers to send/receive money directly on the MoneyGram mobile app or website establishes a direct customer relationship that does not exist when a customer transfers money via a retail agent location. This enables MoneyGram to collect more information on its customers and directly market to them which reduces customer acquisition costs and increases customer retention.

Digital customers have a lifetime value 3x greater than traditional walk-in customers. MoneyGram also noted that the digital product appeals to a different segment of the market. 80% of digital customers are new to the MoneyGram brand, and two-thirds of digital customers are Gen-Z or Millennials. In other words, there appears to be limited cannibalization between digital and retail channels – this is also reflected in the data as retail money transfer volumes have been flat to up over the last 10 years.

Furthermore, directly sending money through the MoneyGram app cuts out the third-party agent commission which makes the service cheaper to customers and more profitable for MoneyGram. For example, in the legacy model, a customer may be charged a $14 fee to send money -- this includes a $4 commission for the sending agent, a $3 commission for the receiving agent, and a $7 commission for MoneyGram (50% gross margin). If a customer sends money directly from the app, MoneyGram cuts the fee to $11 and incurs some additional digital-related expenses to electronically collect funds and verify IDs but still keeps roughly a similar dollar commission which results in a higher gross margin per transaction. In other words, MoneyGram passes along the savings to the customer while only incurring some incremental transaction costs.

**Cash-to-Cash (Walk In) Unit Economics**

| | |
|---|---|
| Value of money being transferred | $300 |
| Total commission charged (Revenue) | $14.50 |
| Send agent commission | $3.50 |
| Pick-up agent commission | $3.00 |
| Bank transaction fees (rates vary) | $1.50 |
| MoneyGram Gross Profit | $6.50 |
| Transaction Gross Margin | 44.8% |

**Digital-to-Cash Unit Economics**

| | |
|---|---|
| Value of money being transferred | $300 |
| Total commission charged (Revenue) | $12.50 |
| No send agent commission | $0.00 |
| Pick-up agent commission | $3.00 |
| Bank transfer & compliance costs | $3.00 |
| MoneyGram Gross Profit | $6.50 |
| Transaction Gross Margin | 52.0% |

**Digital-to-Digital Unit Economics**

| | |
|---|---|
| Value of money being transferred | $300 |
| Total commission charged (Revenue) | $9.50 |
| No send agent commission | $0.00 |
| No pick-up agent commission | $0.00 |
| Bank transfer & compliance costs | $3.00 |
| MoneyGram Gross Profit | $6.50 |
| Transaction Gross Margin | 68.4% |

Source: illustrative diagram based on conversations with industry experts.

Maintaining and growing the digital business is more capital-efficient than the retail network. Notably, agents are paid incentive bonuses and are associated with higher compliance costs and risks. Shifting the mix towards digital is expected to show up in improving returns on invested capital over time.

Finally, MoneyGram's digital transformation has enabled it to establish a B2B division it calls MoneyGram-As-A-Service. This is a new initiative and the company has announced its first two customers: Coinme, a project that lets people buy bitcoin with cash, and Sigue, a competing remittance company focused on Latin America. Many regional remittance companies do not have the scale or know-how to establish a digital infrastructure and MoneyGram is opening its API-based platform to enable its competitors to create digital products for a cut of fees. This is an interesting way for MoneyGram to monetize its platform investments without tying up additional capital to acquire customers – it is also very 'fintechy'. The B2B growth opportunity is not reflected in our financial projections.

## Competitive Benchmarking

MoneyGram's heavy focus on its digital transformation over the last 5 years has positioned the company as both the lowest cost operator and ahead of the competition in terms of the number of markets and corridors where digital money transfer is enabled.

In addition to serving 200 countries with its agent network, MoneyGram has enabled digital transfer in 94 countries (as of Q1 2021). This compares to Western Union which only has digital capabilities enabled in 75 countries, Wise with 88 countries, and Remitly with only 17 send countries.

**Digital Channel Competitors**

| Company Name | Country Footprint | Cash Pick-up? | 2020 Sales | Digital Sales | EBITDA % | EBIT % | Enterprise Value |
|---|---|---|---|---|---|---|---|
| MoneyGram | 200 retail; 94 digital | Yes, everywhere | $1,217 | $230 | 18.0% | 8.2% | $1.7 bn |
| Western Union | 200 retail; 75 digital | Yes, everywhere | $4,220 | $844 | 20.0% | 26.1% | $11.2 bn |
| Wise | 88 digital only | No | $582 | $582 | 16.8% | 11.6% | $10.4 bn |
| Remitly | 17 send / 100 receive | Yes, fewer agents | ~$240 | ~$240 | N/A | N/A | Est. $5bn |
| Xoom | 30 send / 160 receive | Yes, fewer agents | N/A | N/A | N/A | N/A | Acquired @ 5x Revenue |

Source: Financial statements, news reports, company websites.

In terms of pricing, online checks indicate that MoneyGram is generally either the cheapest option or close to being the cheapest option in nearly every corridor analyzed. This includes digital to digital, cash to cash, and digital to cash send/receive methods. Western Union was generally found to be the most expensive way to send money.

For example, when comparing the US to Mexico corridor pricing, MoneyGram was significantly cheaper than Wise, Remitly, and Xoom, especially at lower send amounts. Wise was slightly cheaper than MoneyGram in the US to India corridor but only at larger send amounts.

**US / Mexico Price Comparison (digital to digital)**

| | MoneyGram | Wise | Remitly | Xoom |
|---|---|---|---|---|
| Send $300 / Receive: | MXN 6,126 | MXN 6,027 | MXN 6,048 | MXN 6,075 |
| Fee | $0.00 | $5.17 | $3.99 | $0.00 |
| FX spread | $3.57 | $0.00 | $7.34 | $6.03 |
| Total cost (USD) | $3.57 | $5.17 | $11.33 | $6.03 |
| Cost % | 1.2% | 1.7% | 3.8% | 2.0% |

**US / Mexico Price Comparison (digital to digital)**

| | MoneyGram | Wise | Remitly | Xoom |
|---|---|---|---|---|
| Send $1,000 / Receive: | MXN 20,419 | MXN 20,362 | MXN 20,160 | MXN 20,352 |
| Fee | $0.00 | $15.19 | $0.00 | $0.00 |
| FX Fee | 11.94 | - | 24.47 | 15.18 |
| Total cost (USD) | $11.94 | $15.19 | $24.47 | $15.18 |
| Cost % | 4.0% | 5.1% | 8.2% | 5.1% |

**US / India Price Comparison (digital to digital)**

| | MoneyGram | Wise | Remitly | Xoom |
|---|---|---|---|---|
| Send $300 / Receive: | INR 22,042 | INR 21,458 | INR 22,068 | INR 21,905 |
| Fee (USD) | $0.00 | $2.99 | $3.99 | $2.99 |
| FX spread (USD) | $2.71 | $0.00 | $2.36 | $4.56 |
| Total cost (USD) | $2.71 | $2.99 | $6.35 | $7.55 |
| Cost % | 0.9% | 1.0% | 2.1% | 2.5% |

**US / India Price Comparison (digital to digital)**

| | MoneyGram | Wise | Remitly | Xoom |
|---|---|---|---|---|
| Send $1,000 / Receive: | INR 73,473 | INR 73,491 | INR 73,560 | INR 73,017 |
| Fee (USD) | $0.00 | $8.49 | $0.00 | $0.00 |
| FX spread (USD) | $9.05 | $0.00 | $7.88 | $15.20 |
| Total cost (USD) | $9.05 | $8.49 | $7.88 | $15.20 |
| Cost % | 0.9% | 0.8% | 0.8% | 1.5% |

**US / Saudi Arabia Comparison (digital to cash)**

| | MoneyGram | Wise | Remitly | Xoom |
|---|---|---|---|---|
| Send $300 / Receive: | SAR 1,123 | N/A | N/A | N/A |
| Fee (USD) | $4.99 | N/A | N/A | N/A |
| FX spread (USD) | $0.60 | N/A | N/A | N/A |
| Total cost (USD) | $5.59 | N/A | N/A | N/A |
| Cost % | 1.9% | N/A | N/A | N/A |

**US / Saudi Arabia Comparison (digital to cash)**

| | MoneyGram | Wise | Remitly | Xoom |
|---|---|---|---|---|
| Send $1,000 / Receive: | SAR 3,742 | N/A | N/A | N/A |
| Fee (USD) | $4.99 | N/A | N/A | N/A |
| FX spread (USD) | $2.25 | N/A | N/A | N/A |
| Total cost (USD) | $7.24 | N/A | N/A | N/A |
| Cost % | 0.7% | N/A | N/A | N/A |

Source: price checks were performed using company apps and websites.

This runs contrary to the narrative that digital native competitors are cheaper. MoneyGram is not only price competitive but it is competitively advantaged because it offers cash pick up and has a brand that is more widely recognized by remittance customers globally.

MoneyGram's competitive advantages and ability to offer lower prices appear to be resonating with customers. MoneyGram's digital send business is growing twice as fast as Western Union's digital business and operates at profit similar margins compared to Wise.

MoneyGram's digital business is actively lowering the cost for migrants to send money. Given the global social importance of what MoneyGram is doing, it should be viewed as an ESG friendly investment.

## Management Team

MoneyGram is led by CEO Alex Holmes who is 46 years old and has spent most of his career rising through the ranks internally at MoneyGram and its predecessor company. Holmes was appointed CEO in 2016 and has been instrumental in leading the company's digital transformation. It is clear from the company's earnings calls that

Holmes is not only very focused on investing in the digital opportunity to transform MoneyGram into a true fintech platform, but also that he has a solid grasp of how to run a DTC fintech business.

For example, during the Q1 2021 call, Holmes crisply articulated nuances in how the company optimizes customer acquisition spend and measures the ROI by attributing top of the funnel clicks all the way down to completed transactions and repeat customer relationships.

Our interactions with the company's CFO and investor relations have been positive and productive. The company is upfront regarding its shortcomings and provided clear-cut commentary on the key business drivers and growth priorities.

## Financial Performance and Valuation

At a surface level, historical financial performance looks terrible for MoneyGram. From 2016 to 2020, total revenue declined 25% from $1,629m to $1,217m and Adj. EBITDA declined from $193m to $179m, but under the surface, there is a lot to like.

Retail Money Transfer has declined at a high-single-digit rate for several years; however, this is mostly due to pricing pressure. Retail money transfer volume has been fairly stable. While pricing pressure will probably persist, the business line could surprise to the upside if it doesn't decline as fast as investors expect it to. In fact, the revenue line had positive y/y growth in Q1 2021. Our projection assumes that Retail Money Transfer continues to decline at 9.4% going forward, this is likely too conservative.

Bill Pay and Money Order Revenue declined from $173m in 2016 to $113m in 2020. Bill Pay accounts for most of the decline and won't come back as it is in terminal decline. Money Order revenue is relatively stable but will likely decline at a low-single digit rate going forward. The Money Order segment used to generate $20m+ high-margin investment income by investing the float in fixed income, this revenue will come back if interest rates move higher. The projection doesn't give credit for higher interest rates and assumes Bill Pay and Money Order sales continue to decline.

The stand out is the Digital Money Transfer line which is growing at a rapid rate. Over the past three quarters, the digital segment has shown average y/y revenue growth of 84% and the high growth has persisted in April and May 2021 according to the company. The projection assumes that MoneyGram's digital revenue growth decelerates but posts a CAGR of 35% over the next 5 years. While this may seem high, it could prove to be conservative as MoneyGram's digital growth rate has mirrored its digital pure-play rivals such as Wise which are expected to grow at even faster rates in the coming years.

Margins are another bright spot for the company. Gross profit margin is currently around 46% and is expected to exceed 50% within a few years as the revenue mix shifts towards the digital product. The company's remaining expenses are largely fixed and should benefit from operating leverage as the company grows revenue. The company has a cost-cutting program in place expected to remove 5% of the current fixed cost base. From 2016 to 2020 the company has cut over $220m of fixed cost, roughly 36% of its total fixed costs. The projection assumes fixed cost rise by 2% per year and does not give credit to any additional cost-cutting.

The free cash flow projection benefits from the above and also takes into account reduced interest expense from refinancing and paying down the company's debt load. The base-case financial projection shows EBITDA nearly doubling and free cash flow nearly tripling over the next 5 years. The base case model below is intended to be on the conservative side. Wall Street analysts currently project higher revenue growth and EBITDA margin partially due to adjusting for stock-based comp.

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|---|---|---|---|---|
| Retail Money Transfer | $1,456 | $1,422 | $1,273 | $1,009 | $917 | $889 | $806 | $730 | $662 | $600 |
| Growth % | *6.5%* | *(2.4%)* | *(10.4%)* | *(20.7%)* | *(9.2%)* | *(3.0%)* | *(9.4%)* | *(9.4%)* | *(9.4%)* | *(9.4%)* |
| Digital Money Transfer | $0 | $0 | $0 | $115 | $188 | $280 | $407 | $554 | $699 | $850 |
| Growth % | | | | | *64.0%* | *48.9%* | *45.5%* | *35.9%* | *26.3%* | *21.5%* |
| Bill Pay / Money Order | $173 | $180 | $174 | $161 | $113 | $89 | $79 | $69 | $60 | $50 |
| Total Revenue | $1,629 | $1,602 | $1,448 | $1,285 | $1,217 | $1,258 | $1,292 | $1,353 | $1,421 | $1,500 |
| Growth % | *5.9%* | *(1.7%)* | *(9.6%)* | *(11.2%)* | *(5.3%)* | *3.4%* | *2.7%* | *4.7%* | *5.0%* | *5.6%* |
| | | | | | | | | | | |
| Adj. EBITDA | $193 | $214 | $184 | $160 | $179 | $185 | $199 | $231 | $275 | $332 |
| Margin % | *11.9%* | *13.4%* | *12.7%* | *12.4%* | *14.7%* | *14.7%* | *15.4%* | *17.1%* | *19.3%* | *22.2%* |
| | | | | | | | | | | |
| Adj. Free Cash Flow | $36 | $148 | $4 | $18 | $85 | $70 | $100 | $135 | $181 | $243 |
| Margin % | *2.2%* | *9.2%* | *0.3%* | *1.4%* | *7.0%* | *5.6%* | *7.8%* | *10.0%* | *12.8%* | *16.2%* |

| Capitalization | |
|---|---|
| Stock Price (7/14/21) | $9.82 |
| Fully Diluted Shares | 95.112 |
| **Market Capitalization** | **$934.0** |
| Net Debt | $606.0 |
| **Enterprise Value** | $1,540.0 |

| Current Trading Multiples | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|
| EV / Revenue | 1.2x | 1.2x | 1.1x | 1.1x | 1.0x |
| EV / EBITDA | 8.3x | 7.8x | 6.7x | 5.6x | 4.6x |
| EV / Cash Flow | 21.9x | 15.4x | 11.4x | 8.5x | 6.3x |

On a relative basis, MoneyGram trades at a discount to its peers. According to Wall Street estimates, MoneyGram trades at nearly a 40% discount to Western Union on EV/NTM Revenue basis and a 10% discount on an EV/NTM EBITDA basis. Western Union generates higher margins because it operates at a greater scale. As MoneyGram scales up and expands its digital offering, it should narrow the margin gap.

MoneyGram is hated by Wall Street. According to Capital IQ, of the 22 analysts that cover the stock, there are 1 buy rating, 5 hold ratings, and 1 sell rating, making it a consensus "underweight".

Investors have ascribed more risk to MoneyGram due to its regulatory issues and high debt load, but the dismissal of the regulatory matter and impending debt refinance should catalyze the stock to re-rate higher. MoneyGram should actually trade at a multiple premium to Western Union because it is expected to grow faster and has a greater revenue mix coming from digital services.

Companies categorized as financial technology ("fintech") trade with revenue multiples in the 5x to 10x range and 40x+ on cash flow. MoneyGram has digital pure-play competitors that can help triangulate the potential value of its MoneyGram Online business unit.

Digital remittance company Wise just completed an IPO in July 2021 and now sports a $10.4 billion enterprise value. Last year, Wise generated $419m in revenue and $30m in EBIT which translates to a 25x EV/LTM Sales multiple and a much higher earnings multiple.

Remitly is another digitally-focused competitor that targets a very similar market segment as MoneyGram Online. Remitly is expected to IPO during the second half of 2021 and is reportedly seeking a $5 billion valuation. MoneyGram's digital business alone generates more revenue than Remitly (my own estimate) but MoneyGram's entire enterprise value is less than half of what Remitly may be worth at IPO. This also ascribes no value to MoneyGram's B2B platform initiative.

Both MoneyGram and Western Union will likely see their valuation multiple inflate in the coming years as investors better appreciate their digital businesses and can compare them to the soon-to-be public digital-focused remittance companies.

| | Market Cap | Enterprise Value | EV / NTM Revenue | EV / NTM EBITDA | EV / LTM FCF |
|---|---|---|---|---|---|
| **Money Transfer Peers** | | | | | |
| Western Union (WU) | $9,519 | $11,247 | 2.2x | 8.2x | 11.1x |
| International Money Express (IMXI) | $609 | $655 | 1.5x | 8.3x | NM |
| Euronet Worldwide (EEFT) | $7,356 | $7,192 | 2.4x | 13.8x | 29.1x |
| | | | | | |
| **Fintech Peers** | | | | | |
| Square (SQ) | $109,780 | $109,990 | 5.3x | 116.7x | NM |
| PayPal (PYPL) | $340,953 | $337,580 | 12.5x | 42.3x | 58.6x |
| Wise | $13,360 | $10,391 | N/A | N/A | N/A |
| Remitly | Valued at $1.5bn Summer 2020; Multi-billion IPO expected H2 2021 | | | | |
| | | | | | |
| **MoneyGram** | **$934** | **$1,540** | **1.3x** | **7.4x** | **NM** |

Source: Capital IQ.

Using the MoneyGram projections from above and assuming an 8x EBITDA multiple -- a slight discount to where Western Union trades today -- an investment in MoneyGram could yield an IRR of 31% over the next 5 years. If investors give the company some credit for being a fintech and ascribe a 16x EBITDA multiple, the IRR improves to 55%. If everything goes right, the IRR could be much higher than 55% for the next 5 years but there is no need to make heroic assumptions for the valuation math to work.

**Valued As A Legacy Money Transfer Business**

| | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|
| EBITDA Multiple | 8.0x | 8.0x | 8.0x | 8.0x | 8.0x |
| EBITDA | $185 | $199 | $231 | $275 | $332 |
| Implied TEV | $1,484 | $1,589 | $1,850 | $2,199 | $2,660 |
| Current Net Debt | $606 | $606 | $606 | $606 | $606 |
| Cumulative FCF | $70 | $170 | $305 | $487 | $730 |
| Implied Equity Value | $948 | $1,154 | $1,550 | $2,080 | $2,784 |
| Equity IRR | 3% | 24% | 29% | 31% | 31% |
| MOIC | 1.0x | 1.2x | 1.7x | 2.2x | 3.0x |

**Valued As A Fintech Business**

| | 2021E | 2022E | 2023E | 2024E | 2025E |
|---|---|---|---|---|---|
| EBITDA Multiple | 16.0x | 16.0x | 16.0x | 16.0x | 16.0x |
| EBITDA | $185 | $199 | $231 | $275 | $332 |
| Implied TEV | $2,968 | $3,178 | $3,700 | $4,398 | $5,320 |
| Current Net Debt | $606 | $606 | $606 | $606 | $606 |
| Cumulative FCF | $70 | $170 | $305 | $487 | $730 |
| Implied Equity Value | $2,432 | $2,743 | $3,400 | $4,278 | $5,444 |
| Equity IRR | 578% | 194% | 91% | 66% | 55% |
| MOIC | 2.6x | 2.9x | 3.6x | 4.6x | 5.8x |

As downside protection, MoneyGram is a very likely and attractive acquisition target. If a fintech like Square (or a neo bank) wanted to expand into cross-border money transfer, it would be exceedingly time-consuming and complicated to obtain the money transfer licenses in 200 countries and build the necessary regulatory/compliance infrastructure. Acquiring MoneyGram would be a quick and inexpensive solution.

In the past 5 years, several competitors have tried to acquire MoneyGram. In 2017, Alibaba-affiliated Ant Financial agreed to acquire MoneyGram for $880 million and got into a bidding war with Euronet Worldwide who offered to pay $955 million. Ant won the bidding war by offering $1.2 billion but the deal was blocked by CFIUS for geopolitical reasons. In 2020, Western Union was rumored to have made an acquisition offer for MoneyGram but never agreed to a deal.

With its leading position in digital remittance and its regulatory issues freshly settled, MoneyGram has never been a more attractive acquisition target. If the market doesn't properly value MoneyGram in the coming years, an acquirer will likely step in.

## Key Investment Risks & Mitigating Factors

1. MoneyGram's retail channel declines faster than its digital channel can grow
   a. In the past year, the business has inflected and growth in digital money transfer more than offsets the decline in all other revenue lines.

b. The retail channel posted a positive growth number in Q1 2021 and may not decline as much as is expected due to stabilizing market conditions.
c. The digital product is targeting a different market segment (younger and more affluent customers) and doesn't cannibalize retail very much. 80% of MoneyGram's digital customers are completely new to the company.

2. Rising interest rates increasing the cost of debt
    a. Rising interest rates could increase the cost of debt financing although MoneyGram should still be able to massively reduce its effective interest rates from the current level.
    b. The business has a built-in inflation hedge. If wages rise, migrants can send more money back home and MoneyGram's fees scale with higher dollar volumes.
    c. MoneyGram earns interest from the float and should see free cash flow and margins rise with higher interest rates. In 2019, the company earned $55m in interest income vs. $8m expected for 2021.
    d. The cost structure is largely fixed.
3. Competition resulting in fee pressure and lower market share
    a. The overall market for cross-border money transfer is large and growing. There is room for many large companies to be successful.
    b. Fees will likely continue to fall in the retail channel but at some point will stabilize.
    c. Fees could actually increase in the digital channel now that Wise and Remitly are going public and will face pressure to show revenue and earnings growth.
    d. MoneyGram is the low-cost operator and is able to expand margins with lower fees as the platform continues to scale.
    e. MoneyGram has several sustainable competitive advantages including its well-known brand, the un-paralleled scale of its retail & digital networks, and its best-in-class operational infrastructure.
4. Cryptocurrency disrupting the cross-border money transfer industry
    a. It is currently more expensive to send money via cryptocurrency than with MoneyGram or other traditional rails. Crypto will likely never be the cheapest way to send funds because of the high cost of compute required to maintain the public ledger (based on conversations with fintech engineers).
    b. Cryptocurrency is not likely to gain traction with MoneyGram's core customer who still primarily uses cash. Even in MoneyGram's digital business, 80% of receives are picked up in cash.
    c. Cryptocurrency has a compliance problem that will need to be solved. The money needs to be transferred into a bank account that can verify the funds have not been used in illicit activity.
    d. Cryptocurrency is more of an opportunity than a threat for MoneyGram. Through its prior Ripple partnership, MGI was the first company to use cryptocurrency in cross-border money transfer at scale. MGI currently has a few partnerships with cryptocurrency projects and will be amongst the first remittance companies to figure out how to commercialize the technology if it is found viable.
5. Regulatory risks
    a. Having just come out of 8 years of regulatory hell where MoneyGram spent over $100m on compliance improvement and regulatory oversight, the company now has a best-in-class compliance program.
    b. There is always a risk of future regulatory issues given the nature of the industry; however, the risk is likely greater at MoneyGram's competitors that have not gone through as much oversight and review -- particularly the digital competitors which are widely perceived in the industry to run fast and loose on compliance.