

September 22, 2017

**Dear clients and colleagues,**

At Global Alpha our preference is to invest in rapidly growing industries that are driven by either innovation or mass consumption, such as: The digital payment industry. The idea that everything can be connected, as adopted by the Internet of Things (IOT), and the move from cash to forms of electronic payments such as credit or debit cards will act as tail winds for further growth.

### **How big are cash and check volumes?**

Based on data shared by VISA, the Bank of America reported that there was \$17T in consumer cash and check volumes in 2016 and this number has been growing at a 2% CAGR over the last five years. Not surprisingly, Asia Pacific accounts for 55% of that volume with \$11T of consumer spending, while European and North American markets make up the balance, despite higher card penetration.

### **How big can the consumer electronic payment volume get?**

Consumer electronic payments across the globe are expected to grow at a CAGR of 10.4% between 2015 and 2025 according to the Nilson Report. Additionally, the report predicts increased penetration of electronic payments in the US from the current estimated 60%. In fact cash/checks fell to 26%.

### **What about emerging economies?**

When compared to emerging economies, electronic payments have a higher penetration in developed economies and one of the biggest reason for this is due to the state of emerging markets' infrastructure with regard to: internet, point of sale (POS) connectivity, formal banking relationships, and cultural norms to name just a few. However government policies can act as a catalyst for faster adoption.

For example, in 2002 China created the unified payment network, resulting in the growth of the number of acceptance terminals in China having now reached over 16,000 terminals per million people in the last ten years.

In the case of India, the demonetization of the 500, and 1000 rupee note in November 2016 eliminated 86% of the country's currency. For a society in which the majority of merchants accept only cash, and over half the population does not have a bank account, it was a big shock. The rationale behind the government move was to eliminate counterfeit currency from circulation and move the country toward electronic payments.

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Following demonetization, demand for debit cards increased by 20-25% based on data from Mastercard. Yet debit cards account for ~6% of the total debit volume, despite there being 840M debit cards. In terms of credit cards there are only 30M credit cards in India.

### How have our holdings performed in this industry?

While we acknowledge this weekly commentary may not touch the different facets of this emerging technology, let alone highlight where each region of the world is, we have been active in the space since our inception in 2008. We are invested in names that provide direct, and indirect exposure to the fast growing digital payment industry.

Below are a few highlights on how some of our investments have fared.

#### Wirecard AG:

- Provides customers with electronic payment systems and risk management services.
- Gave us exposure to the growing ecommerce space.
- We exited the position in 2014 as the market cap exceeded our upper limit.

#### Dalenys:

- Payment marketing solutions that aims to increase revenues for online and point-of-sale merchants.
- Gave us exposure to the monetization of audience (B2B) and the publishing of digital content (B2C) segment.
- Exited in 2017 as the company was acquired by Natixis.

#### Paysafe:

- European payment services provider that focuses on e-commerce and online transactions.
- Gave us exposure to online payments.
- Exited in 2017 as the company was acquired by Bidco (Blackstone and CVC Funds).

### What is our current exposure?

We continue to follow the space, and evaluate different avenues of exposure to this rapidly growing and evolving industry. We currently have exposure through companies that provide infrastructure to data security and validation. Below are two companies which give us direct exposure, while we quietly accumulate shares in another. We also own names that are beneficiaries of the growing electronic payment industry.

**VeriFone Systems:** With a history dating back over 31 years, this company has gone back and forth as either being privately or publically owned but has now been public since 2005. It is a facilitator of

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transactions, and does not provide any authorization, or clearing of settlements. It is either the #1 or #2 player in most markets.

We initiated a position in Verifone late last year. The company has introduced multiple new products which should drive top line growth, has divested non-core assets, and is increasing the percent of revenue from services. VeriFone should return to top and bottom line growth in the near future.

**ACI Worldwide:** ACI is a payments company and the gold standard of the global payment network. Their BASE24 family of software products authenticates, verifies and facilitates the electronic movement of money across devices.

Whenever a customer conducts a credit or debit card transaction, it involves a number of systems, including the merchant processor: Visa, MasterCard, or the ATM and the card issuer systems. ACI software essentially provides the "electronic handshake" that connects these systems.

#### **Conclusion**

Global small cap companies are not always known by name, but they almost always touch our daily lives in significant ways. Next time you tap your card to pay for a meal or on your shopping trip it is highly possible the card has been tapped or swiped on a VeriFone terminal, and it is the ACI Worldwide technology that has provided the "electronic handshake" which ensures you have a great experience with the merchant

Have a good weekend.

The Global Alpha Team

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