

April 27, 2012

Dear clients and colleagues,

One of the investment themes in our portfolio since inception has been 'Convenience'. Faced with a fast-paced modern lifestyle, a rapidly growing urban population worldwide seeks convenience to save time, energy or simply the trouble. A Datamonitor consumer survey in 2009 defined convenience as one of the ten mega Global Consumer Trends. Their results showed that 44% of citizens across fifteen countries felt that it was difficult to manage their daily obligations and find time to relax. They focused on leisure time maximization and looked for solutions that could facilitate additional time to do the things that are deemed most important.

Convenience is multi-faceted. Some holdings in our portfolio are engaged in businesses like convenience stores, convenience food and services. For example, Greggs, a popular UK bakery retailer, sells fresh bakery goods, sandwiches and drinks. Monro Muffler Brake, the largest chain of company-operated undercar care facilities in the US, provides a full range of car maintenance services. It targets the \$158B "Do-it-for-me" segment of the US automotive aftermarket industry. FamilyMart, the third largest Japanese convenience store operator, grows aggressively overseas where it has over 10,000 stores vs. 8,500 in Japan.

This week we shall profile the latest addition in the portfolio – Seven Bank. It provides, as the company motto indicates, "Everyone's ATM network, anytime and anywhere, safe and secure".

Seven Bank (8410 JP – ¥198)

www.sevenbank.co.jp/english

Business Overview

Seven Bank is a licensed bank that operates the biggest ATM network in Japan, with over 16,000 ATMs in all 47 prefectures. Most of its ATMs are installed in convenience stores and supermarkets owned by Seven & I Holdings, and the rest in financial institutions, airports, train stations, hotels, hospitals, office buildings, and shopping centers.

The business model is simple: revenue is from ATM fees. Seven Bank is a virtual bank without branches. It partners with 569 financial institutions and charges them ATM fees if their customers use Seven Bank's ATMs to withdraw or deposit money. As a bank, it also allows a customer to open an account online and withdraw, deposit, borrow money or even transfer money overseas via its ATMs. Revenue has good visibility. In FY2011, 650M transactions were conducted; i.e. on average 112.4 transactions per ATM per day. Average transaction charge was ¥131. A quick calculation gives you revenue of about ¥85B.

History

In May 2001, Seven Bank was established in response to the voices of many 7-Eleven customers in Japan who said "It would really be great if there were ATMs in 7-Eleven stores."

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Management

Management is very experienced and stable. Seven & I Holdings, the largest distribution and retailing business in Japan, owns 49% of Seven Bank.

Market Data

Market cap ¥2.4B (US\$1.1B), dividend yield 2.6%, p/e (3/2013): 13.3x, profit margin 19%.

Target Market

There are about 180,000 ATMs in Japan, growing at 1% a year because cash usage is deeply rooted in Japan. Seven Bank aims to increase its market share from 9% to 20%, by following the increasing footprint of Seven & I Holdings and gaining market share from financial institutions.

Competition

The company sees no direct competition. Its business model is unique. Financial institutions tend to reduce their off-branch ATMs because the fees collected are often less than the operating costs due to small scale. Other big convenience stores have ATMs in their stores, but share them with third-parties.

Competitive advantages

- It has the largest ATM network in Japan.
- ATM operations are available 365 days / 24 h, as compared to limited hours at banks' ATMs (8h-21h).
- Operation consistency: All Seven Banks' ATMs are standardized, while competitors' ATMs are shared by various parties whose decisions on location, cards accepted and ATM fees may differ.
- More flexibility for partner financial institutions due to direct ATM connection: This allows its partners to set their own ATM fees tied with different tiers of services. Competitors' ATMs are connected first with an integrated ATM system, then with each financial institution.

Growth strategy

- Short term: to install 1,000 new ATMs per year in Japan.
- Long term: to expand international money transfer business with Western Union; to go overseas.

Risks

- Rising interest rates may cause higher cost of deposits.
- ATM fees charged to banks may decline if banks decide to reduce or waive ATM fees.

Valuation

Target price = ¥376, using DCF model at growth rate of 10% for the next 10 years, 5% at maturity, risk premium of 8%, and payout at maturity of 70%.

Have a nice weekend.

The Global Alpha Team

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