COMMENTARY

November 16, 2018

Dear clients and colleagues,

If you were to look in your wallet or purse right now, would there be more cards or banknotes? Despite what you may have read or heard, the volume of banknotes and coins in the world is on the rise, with an estimated 500 billion banknotes and trillions of coins in circulation. Notes and coins make up 9.6% of global GDP, up from 8.1% in 2011. With trends like these, it is hard to foresee a completely cashless economy in the near future.

The proponents of a cashless society claim it will reduce crime. Robberies will decrease and illegal cash transactions will fall because every financial transaction is recorded. There is also a cost burden of having cash in circulation – the cost of printing bills and minting coins and moving, storing and protecting them. It is estimated that processing cash and cheque transactions and servicing ATMs can account for up to 10% of retail bank costs.

Those opposed to a cashless society cite privacy concerns about other organizations handling personal financial data and the risk of the data being hacked. Also, a system outage or technical glitch could leave customers with no access to their money and retailers with no way of accepting payments. There is also a concern that a cashless society would further increase inequality, with those who cannot afford to be connected or those who are uncomfortable with technology (the elderly) being left behind. The question of fees would also need to be addressed, and the risk of overspending increases as people will swipe or tap their payments without realizing how much they are actually spending.

Adoption rates of a cashless society vary greatly. Sweden is probably the closest to being a cashless society. Only 15% of retail transactions in the country involve cash, just 25% of Swedes use cash at least once a week and most Swedish bank branches no longer handle cash. However, as the reality of a cashless society nears, some Swedes are having second thoughts. The increase in credit card fraud is causing concern and a recent poll noted that 70% of Swedes want to retain the option of paying with cash. In its most recent annual report, Sweden's central bank struck a more cautious tone saying adoption should avoid excluding certain social groups. A parliamentary commission is conducting a review of the likely consequences of a cashless society. The report will be available soon.

Looking elsewhere in Europe, cash accounts for 80% of point-of-sale transactions in Germany and your average German carries 103 euros in cash. The average person in France carries around 30 Euros in cash, and cash accounts for only 45% of point-of-sale transactions in the Netherlands. The UK is split. Compared to two years ago, 23% more people rely almost entirely on cash and there is a record level of cash in circulation (some £73 billion); however, the value of cash payments has declined and electronic payments have increased significantly.

The picture varies in Asia where, curiously, Japan is also resisting electronic payments. For every Japanese citizen there is around $7,000 in cash in circulation, quadruple that of neighbouring South Korea. In addition, the majority of the 1.7 billion people in the world who do not have a bank account or mobile payment solution live in Asia, particularly in India, China and Indonesia.

The US has a large and fragmented banking system. A relatively high percentage of the population do not have credit or debit cards and 30% of the population are underbanked or unbanked and rely on cash to pay for day-to-day expenses. Cash is used in roughly 60% of transactions below $10. According to the Federal Reserve, there are 40 billion banknotes in the US. The value of notes in circulation globally amounts to $1.6 trillion and grew 7% in 2017.

Handling all this cash is costly and not a source of revenue growth, so more and more banks are opting to outsource some or all of their cash management operations. In Scandinavia, almost all of cash in transit is outsourced, and Spain is approaching those levels. Elsewhere there is less outsourcing, and a large proportion of banks and retailers deal with cash transactions internally. In the UK, banks execute cash handling activities themselves around 90% of the time. Herein lies the opportunity for companies who specialize in cash handling services.

To benefit from this outsourcing trend, we recently initiated a position in Loomis, a Swedish company. Loomis offers two business lines to banks and retailers: Cash in Transit includes the transport of some 35 million transfers from branches to safe houses and ATM machines via a fleet of 6,700 armored trucks. Cash Management Services includes the management, stocking, sorting and counting of cash. Loomis operates in 22 countries, mostly in Europe and the US.

Loomis is either the number one or two in terms of market share in many developed countries (US, Scandinavia, Switzerland, France, Spain, UK). Although competition is fierce, the opportunity to grow is supported by increased outsourcing in both developed and immature markets and the possibility of consolidation in the industry with a focus on Europe and Latin America.

The company recently reported its quarterly results, and the signs were encouraging. US sales grew organically across all segments — CIT, CMS and Safepoint. ATM sales also increased. Operating margins improved due to an increasing share of high margin services and higher volumes leading to economies of scale. European sales also grew as a result of acquisitions in Germany, Chile and Finland. France and Sweden were weaker, but restructuring in these regions is almost complete. The Latin American business is growing, with positive trends for storage. Loomis also won new contracts in Norway and Belgium.

The world is moving to a "less-cash", not cashless society, and we believe that Loomis is positioned to benefit from the outsourcing of cash management services.

Have a great weekend.

The Global Alpha team