

September 6, 2019

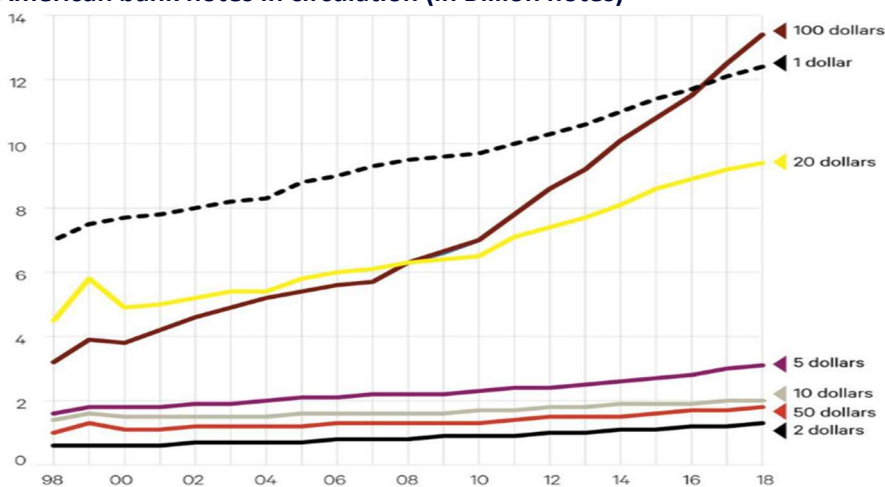
Dear clients and colleagues,

Forecasts often state that cash will be replaced by electronic payment in the near future. While it is true that electronic payment is gaining market share and growing fast, it is unlikely that it will completely replace cash anytime soon. Other current trends, such as negative interest rate and increased cybersecurity concerns, are also keeping the demand for cash at a healthy level.

In fact, the number of bills in circulation has never been so high. In 1990, total currency in circulation in the world passed one trillion United States Dollars (USD). In 2002, this figure was two trillion USD and in 2008, it had increased to four trillion USD. In 2016, the Bank for International Settlements which provides detailed statistics of the worth of bank notes and coins for 18 major currencies used by the member states of the Committee on Payments and Market Infrastructures (CPMI) showed a total value of \$4.7 trillion. The countries where people have the most bills are Switzerland, Hong Kong, Japan, and Singapore.

In the US alone, the following graph shows the growth of bills in circulation.

American bank notes in circulation (in Billion notes)



Source: US Federal Reserve

This week we are profiling a recent addition to the international portfolio – Seven Bank. It provides, as the company motto indicates, “Everyone’s ATM network, anytime and anywhere, safe and secure”.

We actually re-initiated the position as we held it from April 2012 and sold it in January 2014 as it had exceeded our limit market capitalization. Since January 2014, the company stock price has declined by over 34% as the market fears over the disappearance of cash.

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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 25,000 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. In the US, through its FCTI subsidiary, Seven Bank operates around 12,000 ATMs.

The business model is simple - revenue is from ATM fees. Seven Bank is a virtual bank without branches. In Japan alone, it partners with 615 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 fiscal year 2019, 829 million transactions were conducted, which is on average 92 transactions per ATM per day. Average transaction charge was ¥135.

On the banking side, the Bank has over 2 million accounts with a very conservative loan to deposit ratio.

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."

Management

Management is very experienced and stable. Seven & I Holdings is the largest convenience store chain in Japan and the world, and owns 39% of Seven Bank.

Market Data

Market cap ¥3.2B (US\$3.0B), dividend yield 4.0%, P/E (3/2020): 11.5x, profit margin 19%.

Target Market

The target markets for Seven Bank are large. There are about 180,000 ATMs in Japan and 400,000 in the US. Many Banks, both in the US and Japan are reducing the number of branches and ATMs but want to continue offering convenience to their clients and therefore enter into agreement with Seven Bank allowing their clients to use Seven Bank ATMs. Other Banks like PNC want to expand their geographic footprint, without opening physical branches. Seven Bank ATMs allow PNC clients to do all their banking, including opening accounts or taking loans, from the convenience of an ATM.

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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 a year, 24 hours a day, as compared to limited hours at banks' ATMs (8h-21h).
- Operation consistency: All Seven Bank's ATMs are standardized, while competitors' ATMs are shared by various parties whose decisions on location, cards accepted and ATM fees may differ.
- It has a competitive advantage from a logistics point of view as it can use the cash from the convenience store to refill the ATM.
- More flexibility for partner financial institutions due to direct ATM connection, which 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

- Continue to install ATMs in 7-Eleven stores; 7-Eleven has over 68,000 stores. Seven Bank currently has around 30,500 ATMs installed in 7-Eleven, or less than half the stores.
- Long term: Continue to expand money transfers, e-money charges, expand back-office support from financial institutions.

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.

Another catalysts

- Tokyo will hold the Olympics in 2020, continuing a boom in foreign tourists that grew from 8 million in 2010 to over 35 million this year.

Have a nice weekend.
The Global Alpha Team

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