

The Digital Payments Revolution

A Discussion with Artisan Partners Growth Team portfolio managers Jim Hamel, Jason White, Matt Kamm and Craigh Cepukenas

PORTFOLIO MANAGER
Viewpoints

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What do you think is driving the shift toward digital payments?

Jason: We think there are several secular tailwinds contributing to this massive ongoing shift. First, we're seeing rapid growth in e-commerce, which requires that customers be able to make secure, digital payments. The growth in cross-border transactions and the general impact of an increasingly globalized marketplace are helping accelerate this trend. Second, technological innovations that simplify cash transactions—such as Square and Uber, as well as point-of-sale devices in areas they've not historically been, such as taxis, vending machines, parking meters, etc.—are helping drive digital payments growth.

A third factor has been emerging economies' growing push to bring their populations into the formal economy. One way this has manifested itself has been deliberate attempts on the part of some governments—most notably and recently, India's—to demonetize their economies. The move toward digital payments not only brings those consumers into the formal economy, but they can also be faster, more efficient and ultimately, more secure. A final factor has been the growing volume of global travel, which is simpler when transactions are facilitated digitally as opposed to in cash.

Who have been some of the early leaders in this shift toward digital payments?

Jim: Understandably, some of the first movers in this area have been the credit-card companies such as Visa, a holding in the Artisan Global Opportunities Fund, which has played a material role in transforming and advancing digitalization. Visa was also an early innovator in terms of transactional security in the form of tokenization and dual verification—which have been in increasing demand from both users and merchants. Several years into the transition toward digital payments, Visa remains the dominant leader, despite concerns along the way that new payment methods, like Apple Pay, would usurp it. However, rather than being obviated by these new forms of payment, Visa has positioned itself as a facilitator for those transactions, too. The net effect has been to broaden the growth runway, rather than curtail it. Similarly, the meaningful opportunity still ahead in the emerging world implies ample room for future growth.

Jason cited e-commerce as the largest driver toward digital payments—what kind of opportunities are you finding in that area?

Matt: One of the companies capitalizing on the rise of e-commerce is Worldpay, which we hold in the Artisan Global Opportunities and Mid Cap Funds. Worldpay is the product of a recent merger between Vantiv and Worldpay. As independent entities, Vantiv was among the leaders in integrated payments for small merchants and was gaining share in the large national retailer vertical; Worldpay was a leader in the e-commerce field. The combined entity results in a marriage which we anticipate will drive meaningful cost and revenue synergies. Early results have been positive: Sales are accelerating as the combined company capitalizes on the respective strengths of the formerly independent entities to cross- and up-sell into their existing client bases. We anticipate Worldpay will capitalize on its globalized footprint to grow its market share, given its capability to process cross-border transactions that require enhanced fraud protection, which enables higher payment acceptance rates and fewer abandoned online shopping carts.



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18 Years Investment
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You mentioned the emerging world as another driver—are you finding opportunities there as regards digitalization?

Jason: Emerging markets are ripe for digital transactions given many of their financial systems are relatively immature. One advantage emerging markets sometimes have over their developed-world peers is their ability to “skip a step” from a technological progress standpoint. The area of online payments is a good illustration of this phenomenon. Many emerging markets economies remain underbanked—or even relatively unbanked altogether—complicating transactions, whether online or in person. The advent of digital payments is revolutionizing the way in which consumers globally can purchase goods and conduct business.

One company who highlights this trend well is Tencent, a holding in the Artisan Global Opportunities Fund and one of China’s largest Internet companies. Tencent provides gaming, social media platforms and other wireless value-added services, as well as advertising and e-commerce services for enterprises and a digital payments platform. Given its size and importance in the Chinese economy, as well as its meaningful first-mover advantages among a massive population, Tencent is well-positioned to capitalize on the ongoing shift to digital payments.

Matt: Another emerging markets company we believe is attractively positioned in front of this trend is Pagseguro Digital, a holding in the Artisan Global Opportunities, Global Discovery and Mid Cap Funds. Pagseguro Digital engages in the provision of digital payments processing services, with a focus on micro- to small-sized companies in Brazil. The market opportunity is substantial: The vast majority of merchants in Brazil are individual entrepreneurs—a number that has grown rapidly over the last decade or so, despite periodic recessions, and which continues growing rapidly. Relative to developed markets, the Brazilian market remains relatively underpenetrated from a digital payments standpoint, yet it is highly penetrated from a smartphone ownership perspective—providing a compelling intersection of potential tailwinds. We further anticipate that over time, Pagseguro Digital will be able to leverage its base of customers and merchants to add new products and services, broadening its growth runway.

Beyond transaction processing, what opportunities are there within the digital payments transformation?

Craigh: As digital transactions become increasingly common, there is growing awareness of the need for heightened security for online payments—which represents a meaningful opportunity for companies able to capitalize. ACI Worldwide is one such holding we own in the Artisan Small Cap Fund. ACI Worldwide is a provider of financial payment software and subscription-based services. The firm aids in enabling processing of secure transactions, including bill pay, online banking and payments. Increasing complexity is a boon to companies like ACI Worldwide, which can offer financials firms a unified platform, allowing them to manage transactions globally across multiple channels.

Given their scale, are larger financial institutions the primary beneficiaries of this trend versus their smaller competitors?

Craigh: We’re finding this secular trend is disrupting financial institutions of all sizes. One example of this is Q2 Holdings, which we own in the Artisan Small Cap Fund. Q2 provides secure, cloud-based virtual banking solutions which help regional and community banks deliver products and services in high demand from increasingly technologically savvy customers—improving smaller banks’ competitive positioning relative to larger national banks. As more transactions are conducted on smartphones as opposed to in physical branch locations, Q2’s software increases its customers’ appeal to younger clients—in turn helping Q2 take market share from back-end core processors, which tend to be slower-moving industry incumbents.

Matt: Another example is Global Payments, which we own in the Artisan Global Discovery and Mid Cap Funds. Global Payments has been on a multi-year journey to expand beyond its initial offering of credit card payments processing services for small and medium businesses, adding more valuable and stickier software tools that wrap around payments and provide customers an end-to-end solution. In addition, Global Payments has invested to build its own direct sales force, no longer relying on third-party intermediaries, and has successfully entered a growing number of countries—a combination that is translating into faster, more sustainable revenue growth and attractive levels of margin expansion. We find Global Payments to be a good example of the kinds of attractive franchises we’re finding that are exposed to what we believe is still a meaningful, ongoing trend.

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