

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

August 2018

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 Strategy, 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 U.S. Mid-Cap Growth Strategies. 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.



Portfolio Managers (L-R):

Jason L. White, CFA
Portfolio Manager

19 Years Investment Experience

James D. Hamel, CFA
Portfolio Manager

22 Years Investment Experience

Craigh A. Cepukenas, CFA
Portfolio Manager

30 Years Investment Experience

Matthew H. Kamm, CFA
Portfolio Manager

19 Years Investment Experience



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 Strategy 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 Pagueuro Digital, a holding in the Artisan Global Opportunities, Global Discovery and U.S. Mid-Cap Growth Strategies. Pagueuro 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, Pagueuro 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 U.S. Small-Cap Growth Strategy. 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 U.S. Small-Cap Growth Strategy. 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 U.S. Mid-Cap Growth Strategies. 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.

For more information: Visit www.artisanpartners.com

International investments involve special risks, including currency fluctuation, lower liquidity, different accounting methods and economic and political systems, and higher transaction costs. These risks typically are greater in emerging markets. Securities of small- and medium-sized companies tend to have a shorter history of operations, be more volatile and less liquid and may have underperformed securities of large companies during some periods. Growth securities may underperform other asset types during a given period. Investments will rise and fall with market fluctuations and investor capital is at risk. Investors investing in strategies denominated in non-local currency should be aware of the risk of currency exchange fluctuations that may cause a loss of principal. These risks, among others, are further described in Artisan Partners' Form ADV, which is available upon request.

This material represents the views of the investment team as of 31 Aug 2018, and is subject to change without notice. While the information contained herein is believed to be reliable, there is no guarantee as to the accuracy or completeness of any statement in the discussion. Any forecasts contained herein are for illustrative purposes only and are not to be relied upon as advice or interpreted as a recommendation.

Strategy information contained herein relates to a representative account managed within the investment composite. It is intended to provide a general illustration of the investment strategy and considerations used by Artisan Partners in managing the strategy.

For the purpose of determining the portfolio's holdings, securities of the same issuer are aggregated to determine the weight in the Strategy. The discussion of portfolio holdings does not constitute a recommendation of any individual security. These holdings comprise the following percentages of a representative account within the Composite's total net assets as of 31 Mar 2019: Artisan Global Opportunities—Pageseguro Digital Ltd 1.0%, Visa Inc 4.3%, Tencent Holdings Ltd 2.8%, Worldpay Inc 3.3%. Artisan Global Discovery—Global Payments Inc 5.3%, Pageseguro Digital Ltd 0.7%. Artisan U.S. Mid-Cap Growth—Global Payments Inc 5.3%, Worldpay Inc 3.3%, Pageseguro Digital Ltd 0.7%. Artisan U.S. Small-Cap Growth—Q2 Holdings Inc 4.1%, ACI Worldwide Inc 2.5%. Securities named, but not listed here are not held as of the date of this report. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual securities.

This material is provided for informational purposes without regard to your particular investment needs. This material shall not be construed as investment or tax advice on which you may rely for your investment decisions. Investors should consult their financial and tax adviser before making investments in order to determine the appropriateness of any investment product discussed herein. We expressly confirm that neither Artisan Partners nor its affiliates have made or are making an investment recommendation, or have provided or are providing investment advice of any kind whatsoever (whether impartial or otherwise), in connection with any decision to hire Artisan Partners as an investment adviser, invest in or remain invested in any funds to which we serve as investment adviser or otherwise engage with Artisan Partners in a business relationship.

Artisan Partners is not registered, authorized or eligible for an exemption from registration in all jurisdictions. Therefore, services described herein may not be available in certain jurisdictions. This material does not constitute an offer or solicitation where such actions are not authorized or lawful. Further limitations on the availability of products or services described herein may be imposed.

Artisan Partners Limited Partnership (APLP) is an investment adviser registered with the U.S. Securities and Exchange Commission (SEC). Artisan Partners UK LLP (APUK) is authorized and regulated by the Financial Conduct Authority and is a registered investment adviser with the SEC. APLP and APUK are collectively, with their parent company and affiliates, referred to as Artisan Partners herein.

In no event shall Artisan Partners have any liability for direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) losses or any other damages resulting from the use of this material.

This material is only intended for investors which meet qualifications as institutional investors as defined in the applicable jurisdiction where this material is received, which includes only *Professional Clients* or *Eligible Counterparties* as defined by the UK Financial Conduct Authority where this material is issued by APUK. This material is not for use by retail investors and may not be reproduced or distributed without Artisan Partners' permission.

In the United Kingdom, issued by APUK, 25 St. James's St., Floor 3, London SW1A 1HA, registered in England and Wales (LLP#: OC351201). Registered office: Reading Bridge House, Floor 4, George St., Reading, Berkshire RG1 8LS.

Australia: This material is directed at wholesale clients only and is not intended for, or to be relied upon by, private individuals or retail investors. Artisan Partners Australia Pty Ltd is a representative of APLP (ARBN 153 777 292) and APUK (ARBN 603 522 649). APLP and APUK are respectively regulated under US and UK laws which differ from Australian laws and are exempt from the requirement to hold an Australian financial services license under the Australian Corporations Act 2001 in respect to financial services provided in Australia.

Bailiwick of Guernsey: The financial services referred to in this material and this document are not being made available in the Bailiwick of Guernsey (Guernsey) to more than 50 persons in Guernsey and the financial services may not be accepted by more than 50 persons in Guernsey.

Canada: This material is distributed in Canada by APLP and/or Artisan Partners Distributors LLC, which conduct activities in Canada under exemptions from the dealer, portfolio manager and investment fund manager registration requirements of applicable Canadian securities laws. This material does not constitute an offer of services in circumstances where such exemptions are not available. APLP advisory services are available only to investors that qualify as "permitted clients" under applicable Canadian securities laws.

© 2019 Artisan Partners. All rights reserved.

For Institutional Investors Only—Not for Onward Distribution

A R T I S A N



P A R T N E R S