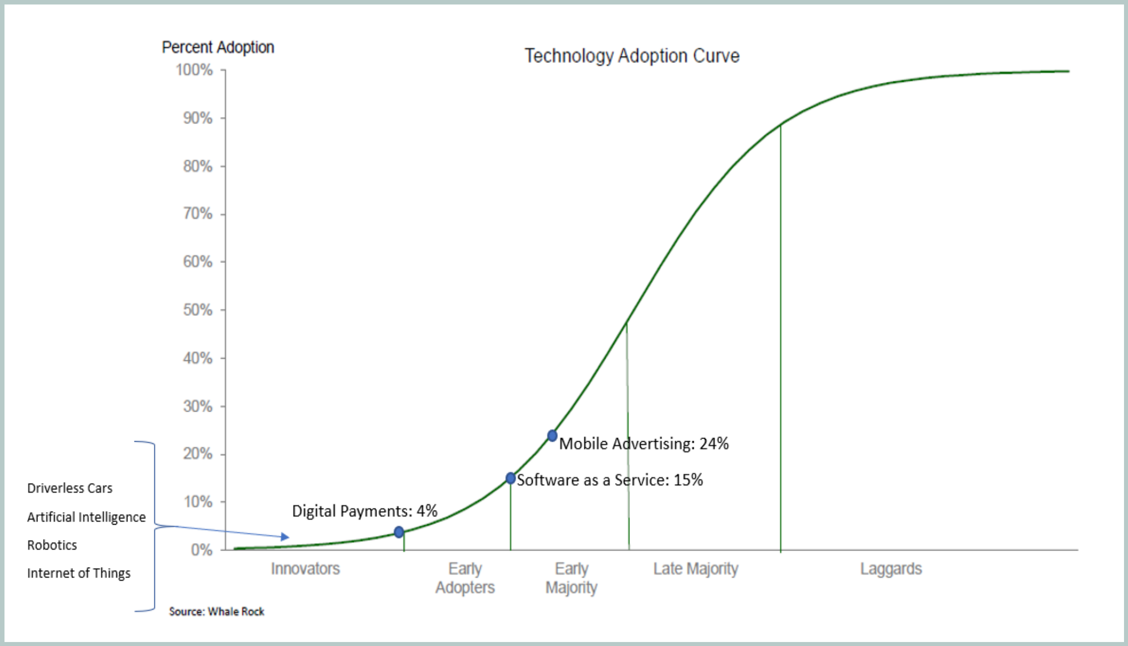
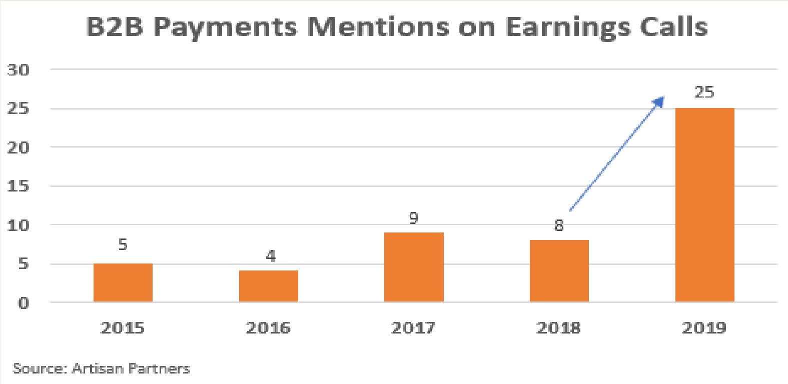
PAYMENTS: AN INDUSTRY IN TRANSFORMATION

Cash is quickly becoming a thing of the past. Digital currency and electronic payments are the new norm, creating a compelling investment opportunity. Advances in payments technology are evident in our daily lives, but the momentum we're seeing is the tip of the iceberg. Growing demand is fueled not only by further innovation, but also adoption of existing payments technologies. Current adoption of digital payments technology hovers around 4% globally, and business to business payments represents a largely untapped source of demand. Also fueling demand is a growing base of smartphone users, particularly in China and Southeast Asia. Chinese consumers have leapfrogged decades of card payments, transitioning directly from cash to mobile wallets. The chart below depicts where electronic payments lies on the adoption curve, right on the cusp of significant growth.

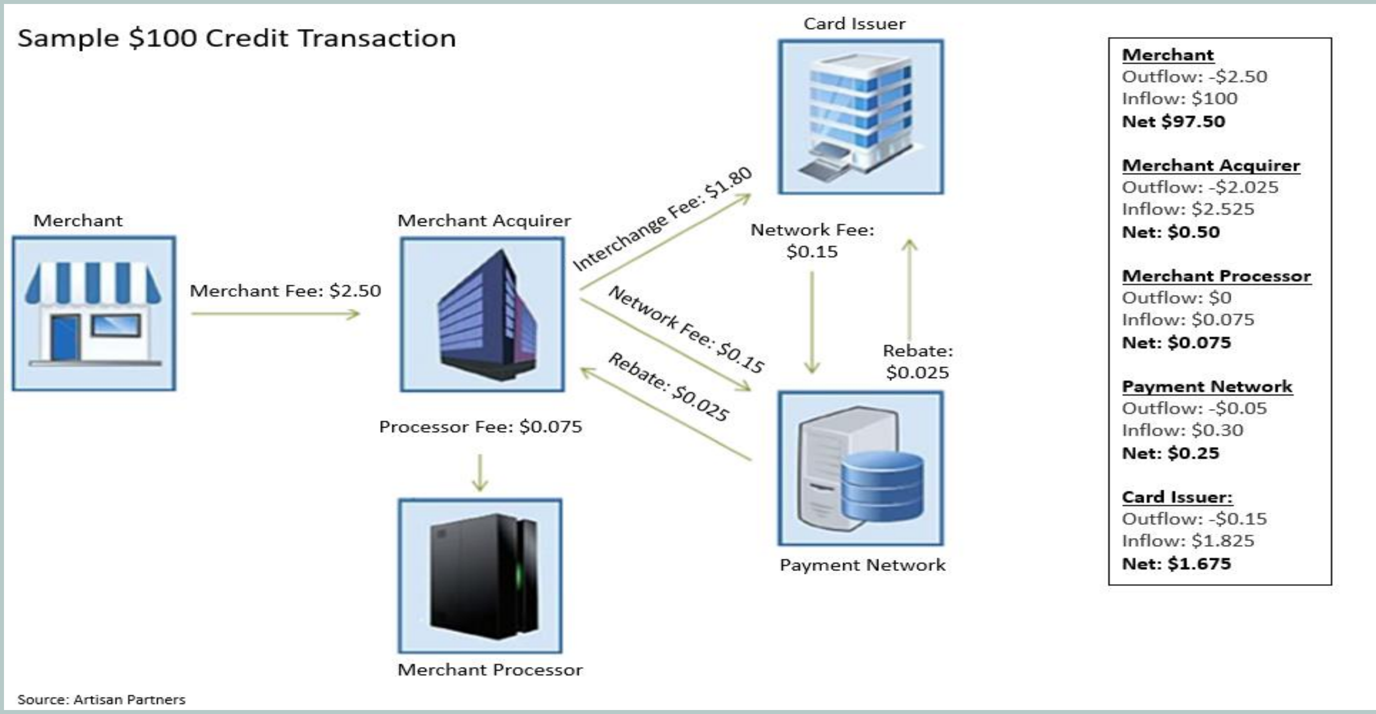


Business to business (B2B) payments represent the largest near-term opportunity for adoption. Currently, over 90% of B2B transactions are conducted via paper invoicing. For most large companies in aging industries, a quick trip to the accounts payable department will convince you to invest elsewhere. High upfront costs of adoption have deterred many corporations until recently, but with mounting pressures from customers and competitors, broad scale adoption appears to be at an inflection point. The chart below demonstrates a significant increase in mentions of B2B payments on earnings calls. QuickBooks and Stripe are two companies experiencing exponential growth through targeting B2B payments. Intuit's QuickBooks combines accounting software and with business payments and payroll functions. Segment revenue grew 41% from 2018 to 2019. Stripe, the leading provider of tools for internet businesses, was valued at $35bb in September, 2019, an increase of $12.5bb since January 2019. The company now offers payments and lending services to millions of businesses across 70 countries. Customers include Amazon, Microsoft, Apple, Facebook, and Google.

The traditional chain of payments involves five entirely separate players. The chart below follows a single $100 credit transaction through the current maze of providers. Each takes a fraction of the payment while adding marginal value. Despite these inefficiencies, the fundamentals of the industry are strong, touting margins up to 51% and EPS growth around 15%. For example, Visa's net income has almost doubled over the past two years, and the company's net profit margin remains high at 52.57%.



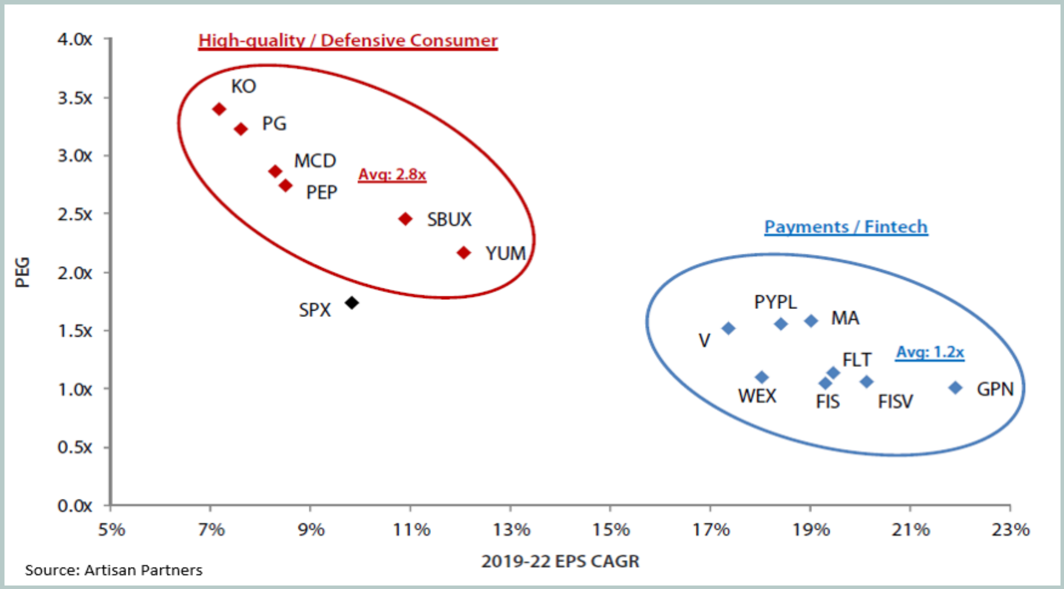
Recent mergers and acquisitions are aiming to make the payments industry even more profitable. M&A in the industry is streamlining once siloed businesses within the payments chain, offering significant efficiencies and costs savings. Consolidation also paves the way for payments companies to deliver advanced reporting and data analytics. For example, QuickBooks processes both revenue and bill payments for many customers, leading to a one stop shop for profit & loss statements and cash flow reports. Another example is Visa's recent acquisition of Plaid for $5.4 billion. In addition to providing valuable consumer spending and lending data, Plaid provides a platform to link bank accounts with mobile apps. Partners include Venmo, American Express, and Fannie Mae. The acquisition positions Visa well to capitalize on the transition from card payments to mobile wallets and in-app purchases.

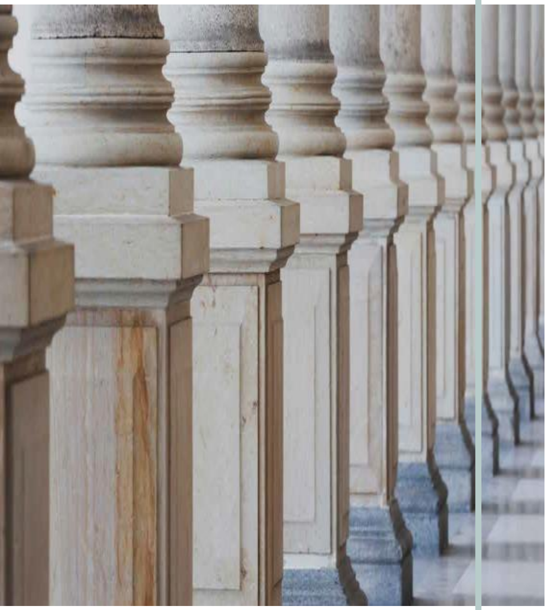


Finally, China and Southeast Asia stand out as leaders in payment technology adoption. A low level of banking penetration coupled with rapid growth in e-commerce has fueled demand. Asia has leapfrogged ahead of the US when it comes to payments technology. Chinese consumers have bypassed card payments, transitioning directly from cash to mobile wallets. A notable example is Grab, a food delivery and digital payments startup in Southeast Asia. Grab was recently valued at $14bb, above each of Southeast Asia's top 15 established banks. Another example is Alipay, a spin-off of Alibaba, that is experiencing significant growth as a mobile wallet provider in China and surrounding countries. Alipay served 1.2 billion customers in the first half of 2019, a 20% jump from the prior six-month period. In addition, the company recently launched a program to expand its mobile wallet services to international visitors and tourists. Many Biltmore clients are participating in Alipay's exciting growth through their investment in Legacy Capital.

Estimates for mobile payment market growth range from 25% to 34% over the next 5 years, fueled by an increasing smartphone user base and the growth of e-commerce. As outlined in the chart below, when compared with high-quality defensive consumer stocks, payments stocks are trading significantly lower on a price/earnings to growth basis.

A rising tide lifts all boats, and the tide is just beginning to rise on digital payments as new capital flows into the space. A deep dive reveals an age-old service at the beginning of a transformation. The Biltmore research team will be expanding investment options around payments. You can expect to hear more about it in the coming months. Thank you, and we wish you a great start to 2020.





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