

The changing world of payments

UBS Asset Management | How to invest in a cashless society

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If beggars in China are accepting electronic payments instead of cash, then something must be going on in the world of payments.

Indeed, cashless, electronic payments are rapidly catching on in emerging markets, and particularly in Asia.

In contrast, more developed areas of the world still rely on traditional means of payment like cash, credit cards, and cheques.

On top of the cashless shift, there's also the prospect of how blockchain can revolutionize how payments get executed and how records are stored.

But with all this change going on, where do the incumbents of the industry, like credit card providers, stand and what does it mean for investors? Here, we assess cashless trends and argue that there's still good prospects for incumbents.

China's leading, but the world isn't following

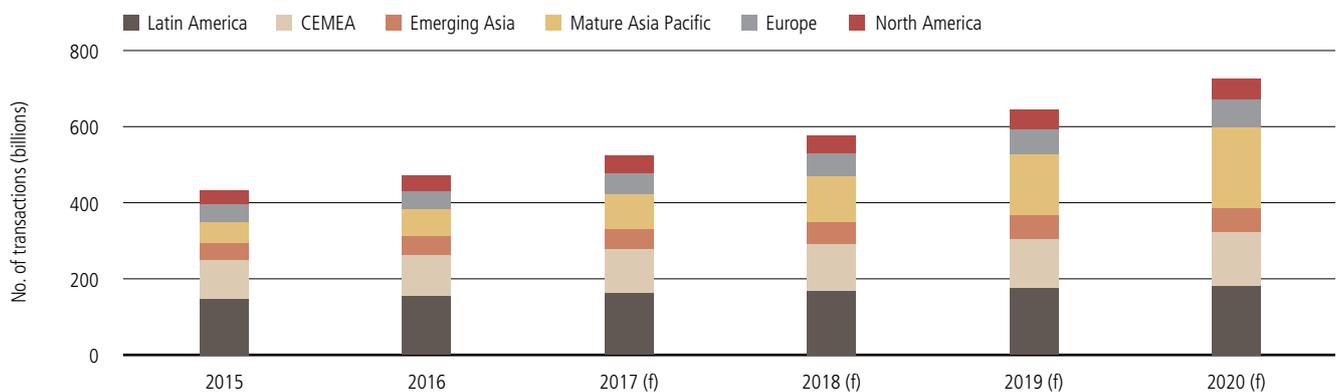
China alone saw USD 15.5 trillion in mobile phone payments in 2017, close to double the amount in 2016, and on the way to surpassing total national credit card payment volumes in 2018, according to iResearch.²

China is leapfrogging from cash to mobile phone payments and rejecting the steps in between. That's mainly because it doesn't have old legacy systems, but it's also because of the rapid growth of e-commerce, innovations from platform providers, and high smartphone penetration.

In contrast, growth in mobile phone payments and digital wallets is much lower in countries where credit cards have long had a large market share. On a global scale, only around 15% of people use mobile phone payments.

Mobile payments have been growing slower on a global level because there are a number of payment providers competing

Exhibit 1: No. of non-cash transactions by region (billions), 2015–2020(f)

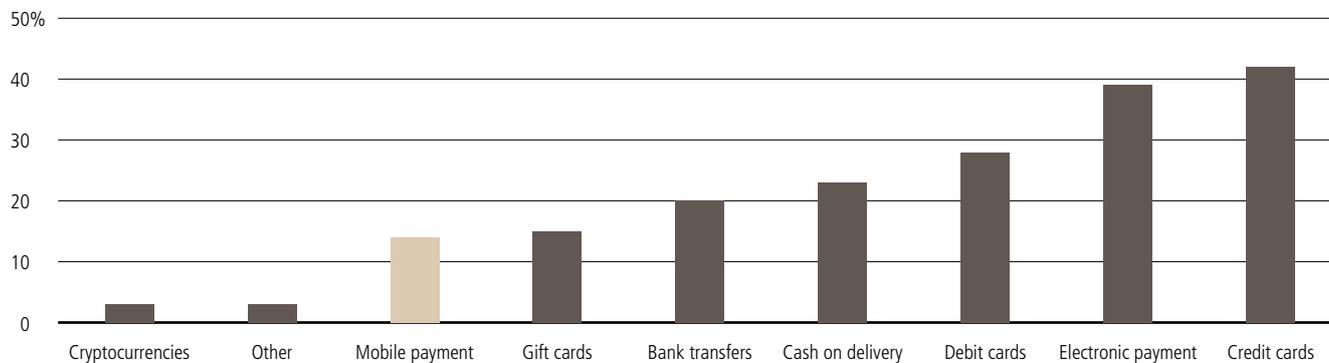


Source: CapGemini, 2017¹

¹ CTMfile: Non-cash transactions continue record global growth but cash still dominates
<https://ctmfile.com/story/non-cash-transactions-continue-record-global-growth-but-cash-still-dominate>

² Next Big Future: China global lead in Fintech and Mobile Payments
<https://www.nextbigfuture.com/2018/02/china-global-lead-in-fintech-and-mobile-payments.html>

Exhibit 2: Preferred payment methods for e-commerce world-wide, 2017



Source: Statista, 2017³

in a fragmented market that has high entry barriers, including technology and infrastructure.

With these conditions in mind, there is a distinct possibility none of the mobile phone providers will win quickly and globally, but credit cards will remain the standard, particularly since they are well established and perceived as secure.

Additionally, many mobile phone payment providers rely on services and infrastructure of established payment technology firms to some degree, so credit card companies continue to benefit from payments even if there is a move from credit cards to mobile phones.

Blockchain has potential but is it convenient?

Blockchain is another part of the cashless story and its technology is ingenious.

Blockchain technology is essentially a new type of internet that allows for decentralized digital information that can be distributed, but not altered.

Information exists as shared and continually reconciled database. As it is hosted by millions of computers simultaneously, records are public, accessible and verifiable as well as incorruptible.

These traits make it an ideal framework for transactions of all sorts, including payments.

But is blockchain the beginning of the end of traditional financial transactions?

We don't believe so.

Blockchain.info⁴ reports that transaction processing speed is slow, with the average number of transactions per second during the past year roughly between 2,000 and 3,000. In contrast, traditional credit card providers such as Visa can process up to 10 times that volume.

This shows that digital currencies are still quite far away from being useful on a large scale in daily life. Visa and Mastercard are accepted at more than 44 million locations globally.

Should your local coffee shop accept Bitcoin, paying for your morning cappuccino with the cryptocurrency would more than likely take about 10 minutes to clear and settle—much longer than tapping your credit card.

³ Statista: Preferred payment methods of online shoppers worldwide as of March 2017
<https://www.statista.com/statistics/508988/preferred-payment-methods-of-online-shoppers-worldwide/>

⁴ Blockchain info
<https://blockchain.info/charts/transactions-per-second?timespan=1year>

Why Visa is more than a credit card company

In our UBS Global High Conviction fund, we own Visa.

We see Visa as more than a credit card company—it is a payment technology company.

Visa enables global commerce through the transfer of value and information among the participants.

Visa is also an established company with a large-scale transaction processing network that facilitates authorization, clearing and settlement of payment transactions and enables it to provide a range of products, platforms and services to its financial institution and merchant clients.

We like Visa as it benefits from huge economies of scale given its leading global position, and operates in an environment where we see fair competition.

We estimate that the continuing shift away from cash payments towards cards and electronic payments means that sales growth should average approximately 10% for the next five years, while operating leverage and use of cash for buybacks should lead to mid-teens earnings-per-share growth.

Competitive risks appear fairly low, with many supposed competitors like PayPal and ApplePay actually utilizing the card networks.

In summary, while the transition from a traditional economy to a digital one continues apace, Visa - as an incumbent - is well positioned because it has a large existing business with a profitable global network.

More than that, Visa's networks provide the backbone and infrastructure for transactions of all kinds, giving it strong exposure to the fast-emerging cashless space.

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