

3 Digital Payment Stocks for Growth Investors

What's in your wallet? The credit card market is growing - as millions of global digital payments take place every day, could these stocks help you get a slice of the pie?

Jim Sinegal | 27 March, 2015 | 9:20AM



How many times a day do you use your credit or debit card? According to the World Payments Report there were 366 billion non-cash transactions globally in 2013, with three quarters of transactions taking place in developed markets.

Emerging markets may have the minority share – but transaction growth is accelerating at a much faster rate, up 18.3% in 2013, compared to global growth of 7.7%.

We examine three stocks that are best placed to take advantage of this digital trend.

Visa (V)

Visa dominates the global market for electronic payments, accounting for about half of all credit card transactions and roughly three fourths of debit card transactions in recent years, according to the Nilson Report. The company primarily earns fees based on the volume of payments made under the Visa brand and the number of transactions processed through the Visa network. In a world in which the number of digital payment transactions is constantly growing, this wide-moat company should flourish.

The next five years are likely to see rapid changes in the nature of the payment business as cards are slowly replaced by electronic payment methods. This presents an opportunity for Visa in the form of volume growth tailwinds, but also a threat as new competitors attempt to manage the payment process and develop new ways to authenticate payments.

We think Visa is on track to ensure that its connections in the virtual world are as plentiful and secure as they are in the physical, and competitors will have a tough time replicating the network's offering.

We've long believed that new payment methods would incorporate, rather than disrupt, Visa's business. We think Apple Pay's early success supports this thesis. Complex international regulatory regimes create a significant barrier to entry, and we still see the successful coordination of financial institutions and merchants around the world as a herculean task.

Mastercard (MA)

In our view, the MasterCard network functions as a tollbooth on financial transactions, generating a small amount of revenue from every transaction that runs through its network, and every dollar of payments made using the MasterCard brand.

At present, we estimate that about 85% of global transactions are still made with cash. We expect that MasterCard will eventually process a much larger share of these transactions, resulting in healthy top-line growth for years to come. MasterCard's global presence strengthens this tailwind even further – well over half of revenue is generated outside the United States.

Over the next decade, we expect the economies of developing nations to grow faster than those of developed nations, we expect consumer spending to grow within those economies, and we expect those consumers to move away from cash at a rapid rate. We therefore think little can stand in the way of MasterCard's expansion, especially in the near term.

American Express (AXP)

American Express relies on powerful network effects and the valuable intangible asset associated with its brand in order to generate excess economic profits. Over the years, American Express has assembled a base of big-spending cardholders by offering exceptional rewards and services. These affluent customers are attractive to merchants, who willingly pay higher discount fees to American Express.

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Securities Mentioned in Article

Security Name	Price	Change (%)	Morningstar Rating
American Express Co	78.43 USD	0.82	★★★★
MasterCard Inc Class A	87.60 USD	-0.08	★★★★
Visa Inc Class A	66.13 USD	0.72	★★★

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In turn, high discount fees fund the company's rewards programs, making the company's offerings more appealing to cardholders and completing a virtuous circle. American Express' closed-loop network both issues cards to consumers and acquires transactions from merchants.

As such, American Express possesses a vast amount of valuable data about the spending habits of its prosperous cardholders. The company is still in the early stages of monetising this data but American Express' unique knowledge of spending patterns is a clear source of opportunity.

American Express' closed-loop network is also somewhat resistant to regulatory change compared with networks that set interchange fees for participants. Unfortunately, American Express' reliance on superior rewards is also the biggest competitive threat to the company. Other issuers are aggressively targeting American Express customers with ever-increasing levels of rewards and services, and we expect this phenomenon to slowly take a toll on the firm's profitability.

The introduction to this piece was written by the Morningstar UK editorial team

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