

Hyperion Asset Management

Company Profile Mastercard Incorporated Class A

Main Business Activities

Mastercard Inc (Mastercard) provides Banks/Traditional Financial Institutions, and their end-customers (individual consumers and merchants), with a reliable and secure payments system (network) that is accepted and trusted across the globe. Mastercard (and Visa) are most often described as global payment rails.

Consumer payment solutions are provided in a number of ways (both offline and online) through a wide range of Mastercard-branded products, allowing service providers (largely banks and traditional financial institutions), to facilitate consumer to merchant money movements through credit, debit, and prepaid cards/tokens (physical and virtual) as well as cash access programs.

In addition to the traditional consumer payments network (approximately \$45 trillion in flows), Mastercard is targeting an additional \$70 trillion in global flows across areas including Business-2-Business (B2B), Government-2-Business (G2B), Business-2-Consumer (B2C), Peer-2-Peer (P2P) and Government-2-Consumer (G2C). This is likely to be largely addressed through Real Time Payments & Automatic Clearing House networks that Mastercard has built or is building (typically in conjunction with governments and central banks), or has acquired (i.e. Vocalink).

Mastercard also provides other value-added services including fraud and risk management, debit issuer processing, loyalty services, dispute management, other digital payment services, as well as business consulting, cybersecurity and data analytics services.

Key Value Proposition to Customers

Merchants require a reliable payment system that is widely used by consumers and consumers want an electronic payment mechanism that is accepted by all mainstream merchants globally.

Mastercard provides fast, reliable, and secure payment processing for merchants and issuers (as well as lucrative fees for the banks), and in addition, offers consumers generous consumer protection policies (zero liability).

Mastercard is also expanding outside of this traditional consumer payments network to offer payment solutions with a superior value proposition to traditional methods in B2B, G2B, B2C, P2P and G2C. For example, Mastercard's B2B strategy focuses on accounts payable flows, which is primarily addressed with account-based payments.

Multiple pain points exist in this area including:

- 1) Lack of visibility into supplier payment preference and acceptance conditions;
- 2) Managing cash flow due to inability to enforce payment terms;
- 3) Limited remittance data associated with a payment makes reconciliation difficult; and
- 4) Limited automation due to lack of established common standards. Targeting opportunity with Mastercard Track, an open-loop commercial payment service – a single connection enables access to multiple payment types, greater control and richer data to optimise B2B transactions.

Given the size of the payments market and the customer insights payment data can provide, many players attempt to enter the space, but largely try to improve the consumer experience and partner with a payments processor. The value proposition to these entrants is they can focus on innovating the consumer experience and leave Mastercard to take care of the payments 'plumbing'.

The Services division has also become increasingly important to Mastercard's overall value proposition providing loyalty, rewards, advisors, security, data analytics to merchants and banks. This provides Mastercard with a way to differentiate itself however is somewhat less important now Visa has chosen to also offer similar services.

Sustainable Competitive Advantages and Outlook

Mastercard benefits from an extremely strong network effect with global coverage across merchants, consumers, and banks. Card acceptance is a necessity in developed countries and now becoming increasingly important in emerging markets. Mastercard (and Visa) provide the backbone of the global payments network and it would be extremely difficult, if not impossible, to disintermediate their core business. Mastercard is choosing to partner with FinTech's, rather than ignore them and face the risk of being disrupted. The platform is also very efficient due to huge scale benefits that are growing as more volume accrues to the networks. This scale is only replicated by Mastercard's main competitor, Visa.

Overall Company Growth Options

Mastercard has the benefit of the secular trend away from paper-based forms of payment to electronic forms of payment. Approximately 43% of global Personal Consumption Expenditure is still in cash and cheque and is still growing. The number of transactions in cash remains high given the relatively faster economic growth being experienced in emerging markets (which are significantly cash based). This has meant the ratio has remained unchanged historically despite the pervasiveness of digital payments in the western world. Mastercard also has a significant opportunity to target low-value transactions through contactless payments, where cash still accounts for 55% of all transactions of value less than \$10.

By building out new functionality and targeting the opportunities in B2B, G2B, B2C, P2P and G2C, Mastercard has increased its total addressable market from \$45 trillion to \$255 trillion. At the company's 2021 Investment Community Meeting it was noted that \$115 trillion of these payment flows are specifically being targeted.

Mastercard is also diversifying its business away from solely transaction processing to value added services such as business/data analytics, increased fraud/risk prevention, online marketing analysis.

We note that the COVID-19 pandemic has created a short-term disruption to the business, largely in cross-border volumes. Hyperion believe the long-term growth is ongoing with the migration from cash/cheque to digital payments being structural. Hyperion expect cross-border travel, specifically personal travel, to return as global vaccination rates continue to improve.

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