Ninepoint International Small Cap Fund Market View

October 09, 2020

Dear Clients and Colleagues

Investment Team

The COVID-19 pandemic has resulted in widespread structural dislocations in the global economy, largely due to unprecedented social distancing measures and lockdowns. At the same time, it has accelerated a secular shift towards digital payments that might have taken years otherwise. During this troublesome time, when a significant share of the global economic activity is migrating online, the payments industry plays an essential role, as it enables consumers, businesses, and governments to transact in the absence of face-to-face interaction.

The World Health Organization, governments, monetary authorities, and merchants worldwide urge using contactless payments over cash due to fear of spreading the virus and germs through physical money and cheques. Some emerging market (EM) countries went as far as sterilizing cash to help stop the virus from spreading. Credit card networks are increasing the limits for contactless transactions at the point of sale without entering a PIN code.

Meanwhile, consumers are adapting how they shop. The recent increase in digital payments is underpinned by the surge in e-commerce, home meal deliveries, and curbside pick-ups. People are currently testing the waters and some are placing their first online orders ever. Those who are familiar with the process will be inclined to continue using digital payments even when the pandemic winds down. According to Boston Consulting Group (BCG), in the early months of the pandemic, roughly 50% of consumers in the United States (US) were shopping online more frequently. SMEs are adapting quickly and have begun accepting contactless payments.

The widespread lockdown has had a terrible impact on most economic sectors, with some finding themselves on the edge of survival and awaiting governmental support. For example, discretionary spending, including restaurants, lodging, entertainment, and airlines, were hit very hard by the pandemic. According to JP Morgan's analysis, discretionary expenditures accounted for about 55% of total credit and debit card spending in the US in 2019. Therefore, most payment companies will face growth headwind in the near term. The impact will vary depending on sector exposure, client portfolio, and value proposition.

Looking past the pandemic, industry prospects in the medium and long terms remain buoyant. BCG sees payment revenues globally growing to $1.8 trillion by 2024, from $1.5 trillion in 2019. This implies a compound annual growth rate (CAGR) of 4.4%, which, although substantial, is still lower than the 7.3% CAGR the industry recorded over 2014-2019. The second half of the decade is expected to be more lucrative for the payments industry, as its global revenues growth should accelerate to 5.6% per year and reach $2.4 trillion by 2029.

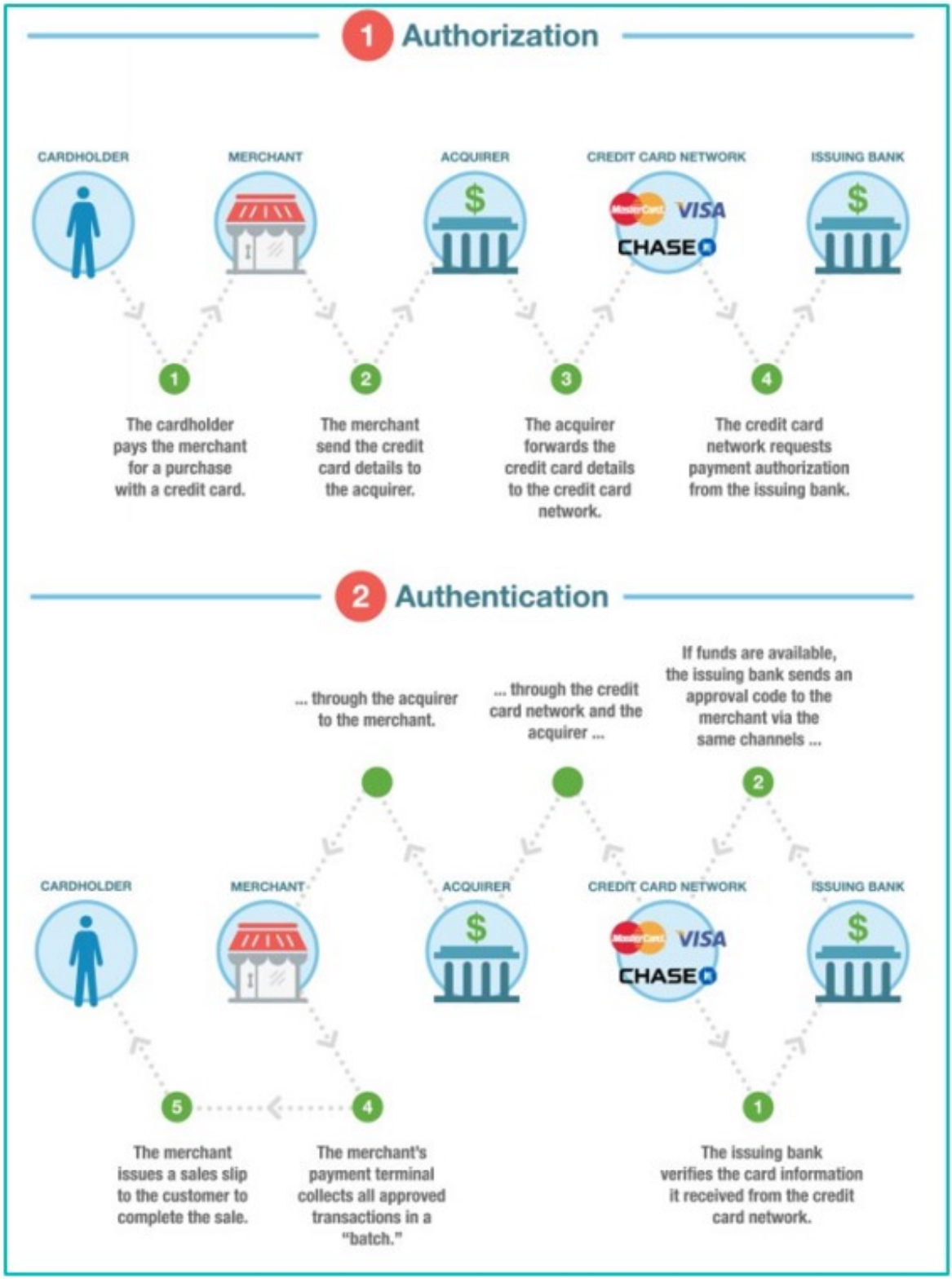
As the industry is becoming increasingly crowded, many emerging players leverage technological innovations to compete with incumbents and become the issuer, acquirer, network provider, or partner of choice. The likely winners in the post-pandemic period will be those who use this period to adapt, reinvent their business model, and rebalance the product and client portfolios to gain the scale and nimbleness.

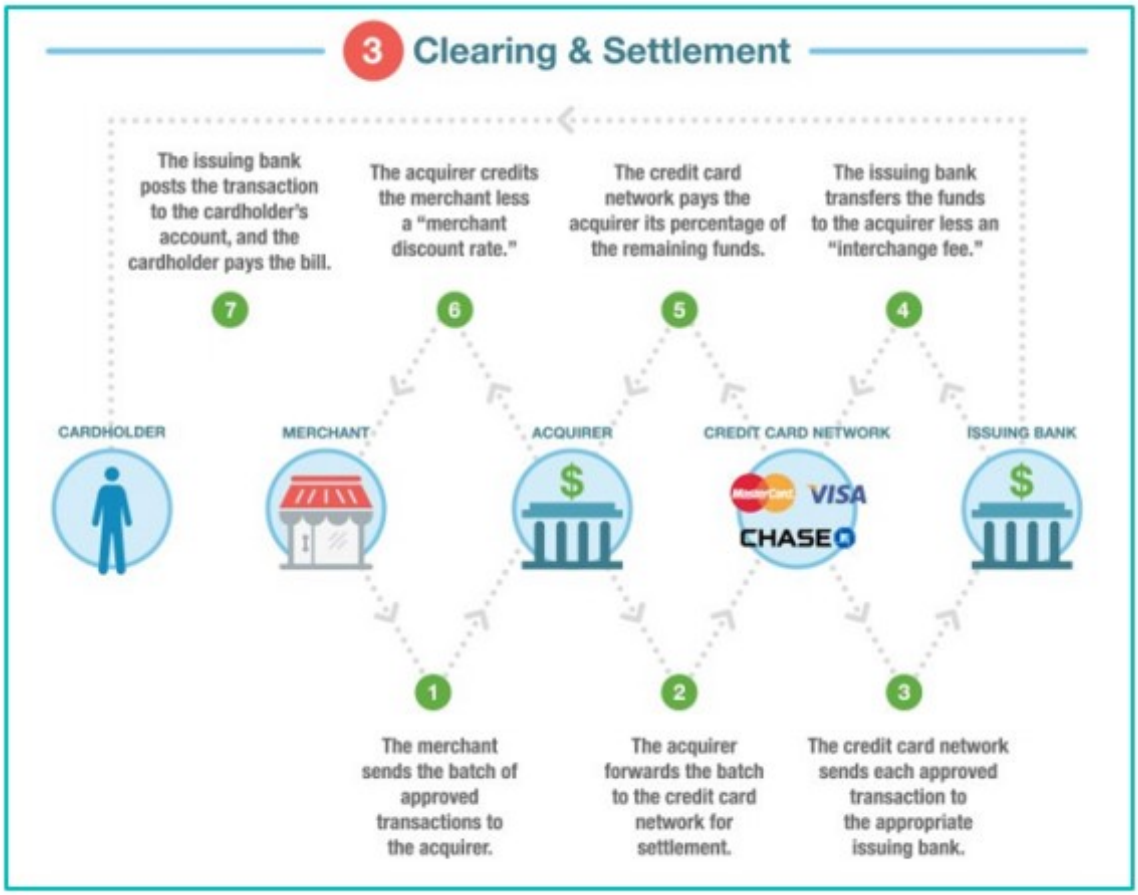
While the digital payments' backbone is becoming almost invisible, there is a complex ecosystem of participants facilitating the transactions. In this commentary, we want to shed some light on the mechanics of the consumer-to-business (C2B) payments. Unlike business-to-business (B2B) and business-to-consumer (B2C) payments, which are predominantly handled by banks, C2B payments need to be processed in real-time. That is where credit cards come in handy with lots of value-added features. Therefore, the C2B space attracts the main interest of the payments industry players, and that is where they earn the most considerable portion of their revenue.

A regular C2B transaction involves several parties:

- the consumer (credit or debit cardholder);
- issuing bank or credit card lender (authorizes the transaction and guarantees payment on behalf of the cardholder);
- the merchant (business providing goods or services to the consumer in exchange for the payment);
- acquiring or merchant's bank (allows access to the network for the merchant, ensures that the merchant receives payment quickly and securely); and
- credit card network (connects all the counterparties to make the transaction possible, e.g. Visa, MasterCard or AmEx).

C2B transactions can be processed through different platforms, including brick-and-mortar stores, online stores, wireless terminals, smartphones, or other mobile devices. Every transaction has three steps: authorization, authentication, and clearing and settlement, as depicted in the following graphics.


1 Authorization
CARDHOLDER
MERCHANT
ACQUIRER
CREDIT CARD NETWORK
ISSUING BANK
VISA
CHASE
1
The cardholder pays the merchant for a purchase with a credit card.
2
The merchant send the credit card details to the acquirer.
3
The acquirer forwards the credit card details to the credit card network.
4
The credit card network requests payment authorization from the issuing bank.
2 Authentication
... through the acquirer to the merchant.
... through the credit card network and the acquirer ...
If funds are available, the issuing bank sends an approval code to the merchant via the same channels ...
2
CARDHOLDER
MERCHANT
ACQUIRER
CREDIT CARD NETWORK
ISSUING BANK
VISA
CHASE
5
The merchant issues a sales slip to the customer to complete the sale.
4
The merchant's payment terminal collects all approved transactions in a "batch."
1
The issuing bank verifies the card information it received from the credit card network.



Source: https://wallethub.com/edu/cc/credit-card-transaction/25511/

This complex interaction remains almost invisible and is completed within seconds. Depending on the platform used and type of merchant, payment processing rates will vary. For example, if a consumer swipes or taps their card at a coffee shop to pay for a purchase of $10, the merchant collects only $9.70. The balance is called the merchant discount rate (MDR) and is distributed between the issuer, acquirer, and network, with the issuer getting the larger chunk of MDR to compensate for the credit risk associated with the consumer.

Despite the payments industry becoming more congested, it appears challenging to find quality players in the small-cap space without neglecting mind-boggling valuations. One of our holdings, ACI Worldwide, is a provider of payment solutions for banks, financial intermediaries, billers, and merchants. ACI's products are the gold standard for the industry and facilitate the many of the steps described above. The company is well-positioned to benefit from the secular trends driving growth in the digital payments industry. As SaaS/PaaS revenue is gaining a larger share of the sales mix, the company will deliver a more consistent growth path and margins. A significant discount to peers that the market attributes to ACI stock presents an attractive opportunity with a comfortable margin of safety.

Have a great week ahead.
The Global Alpha Team

MONTHLY RETURNS (%) AS AT SEPTEMBER 30, 2020, (SERIES F NPP371)

	1M	YTD	3M	6M	1YR	INCEPTION
Fund	1.7%	-7.9%	6.7%	18.8%	1.9%	0.2%
Index	1.8%	-1.3%	8.1%	24.0%	7.8%	0.6%

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at September 30, 2020; e) since inception (March 15, 2018). The index is 100% MSCI EAFE Small Cap NR USD (CAD) and is computed by Ninepoint Partners LP based on publicly available index information.

Ninepoint Partners LP is the investment manager to a number of funds (collectively, the "Funds"). Commissions, trailing commissions, management fees, performance fees (if any), and other expenses all may be associated with investing in the Funds. Please read the prospectus carefully before investing. The indicated rates of return for Series F of the Funds for the period ended September 30, 2020 are based on the historical annual compounded total returns including changes in [unit/share] value and reinvestment of all distributions or dividends and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. This communication does not constitute an offer to sell or solicitation to purchase securities of the Funds.

The Fund is generally exposed to the following risks. See the prospectus of the Fund for a description of these risks: ADR risk; Concentration risk; Credit risk; Currency risk; Cybersecurity risk; Emerging markets risk; Foreign investment risk; Inflation risk; Liquidity risk; Market risk; Regulatory risk; Securities lending, repurchase and reverse repurchase transactions risk; Series risk; Small company risk; Specific issuer risk; Sub-adviser risk; Tax risk.

The information contained herein does not constitute an offer or solicitation by anyone in the United States or in any other jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation. Prospective investors who are not resident in Canada should contact their financial advisor to determine whether securities of the Funds may be lawfully sold in their jurisdiction.

The opinions, estimates and projections ("information") contained within this report are solely those of Ninepoint Partners LP ("Ninepiont") and are subject to change without notice. Ninepoint makes every effort to ensure that the information has been derived from sources believed to be reliable and accurate. However, Ninepoint assumes no responsibility for any losses or damages, whether direct or indirect, which arise out of the use of this information. Ninepoint is not under any obligation to update or keep current the information contained herein. The information should not be regarded by recipients as a substitute for the exercise of their own judgment. Please contact your own personal advisor on your particular circumstances.
Views expressed regarding a particular company, security, industry or market sector should not be considered an indication of trading intent of any investment funds managed by Ninepoint. Any reference to a particular company is for illustrative purposes only and should not to be considered as investment advice or a recommendation to buy or sell nor should it be considered as an indication of how the portfolio of any investment fund managed by Ninepoint is or will be invested.

Ninepoint and/or its affiliates may collectively beneficially own/control 1% or more of any class of the equity securities of the issuers mentioned in this report. Ninepoint and/or its affiliates may hold short position in any class of the equity securities of the issuers mentioned in this report. During the preceding 12 months, Ninepoint

and/or its affiliates may have received remuneration other than normal course investment advisory or trade execution services from the issuers mentioned in this report.

Ninepoint Partners LP: Toll Free: 1.866.299.9906. DEALER SERVICES: CIBC Mellon GSSC Record Keeping Services: Toll Free: 1.877.358.0540