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CAPITAL ADVISORS

Overview of the Payment Processing Industry

DECEMBER 2023



Table of Contents



I.	Payment Processing Overview	3
II.	Differentiating Factors Between Payment Processors	10
III.	M&A Trends in Payment Processing	13
IV.	Other Representative M&A Transactions	20
V.	Future Trends	23
VI.	Summary	26



I. Payment Processing Overview

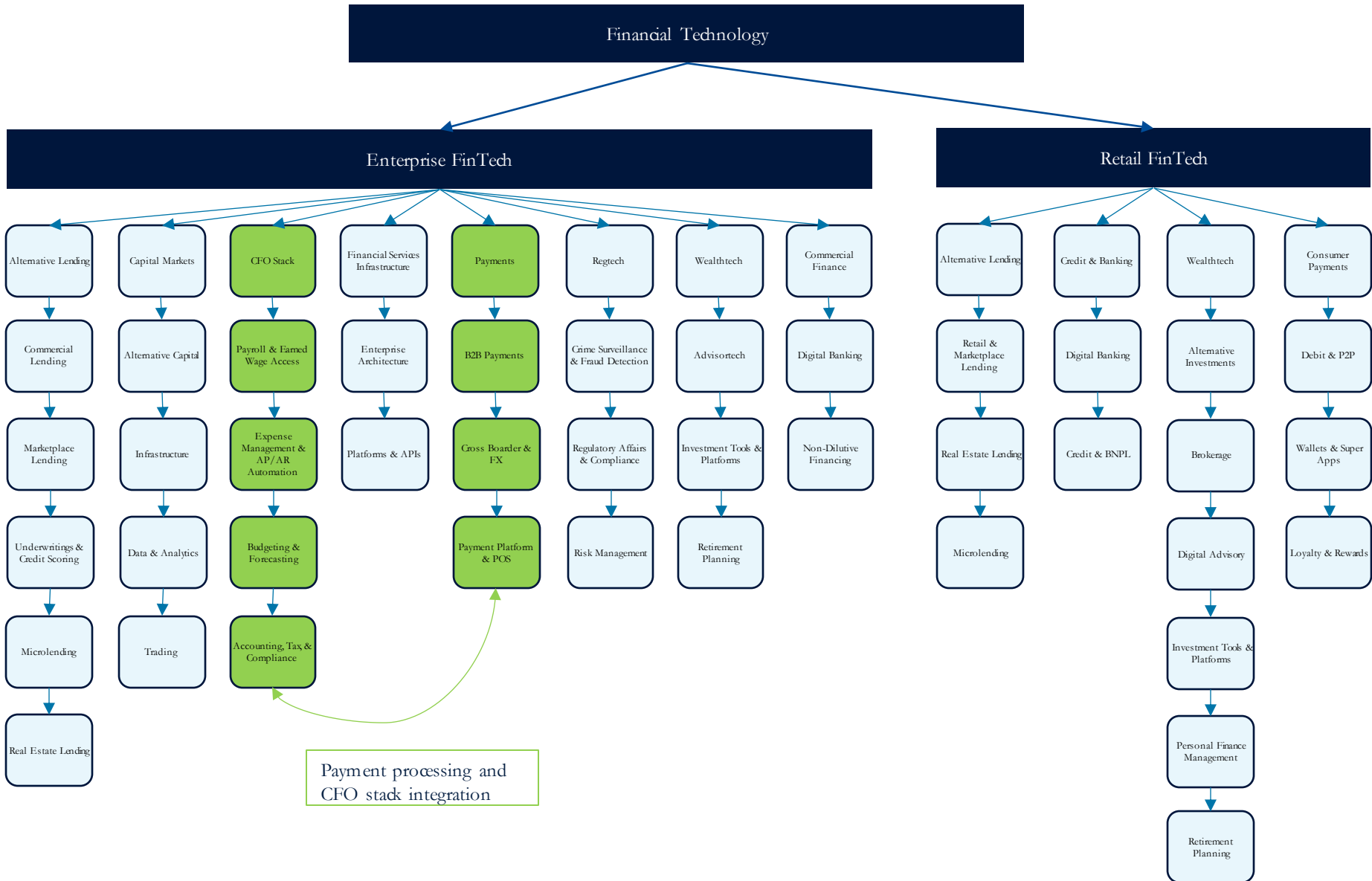


History of the Payment Processing Industry

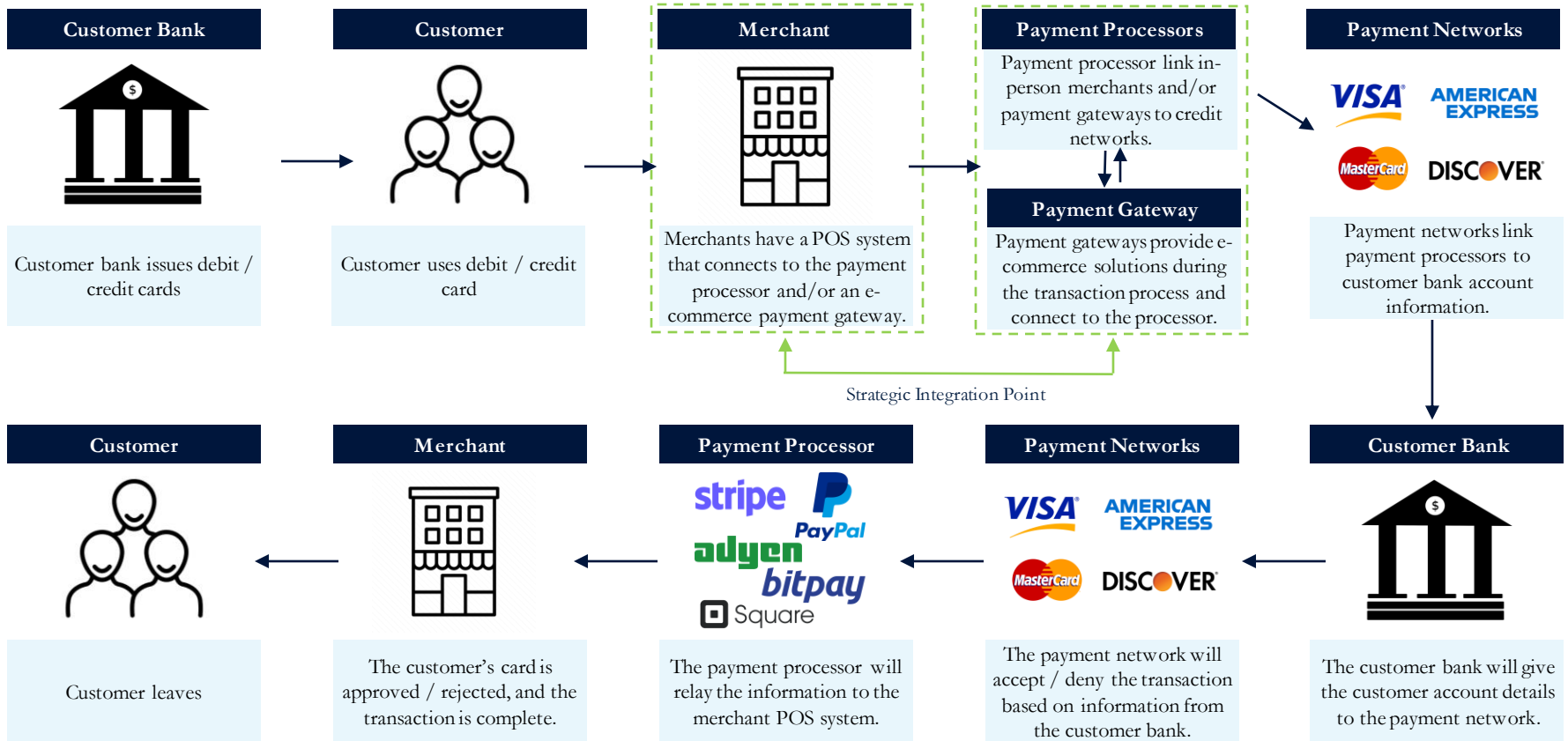


	Paper Era: Pre-1960s	Plastic Era: 1960s-1990s	Account Era: 1990s – 2020s	Decoupled Era: 2020s
Transactions	Cash, checks, and wire transfers	Cash, checks, wire transfers, and physical cards	Instant transfers, A2A, and virtual cards	Interoperable and open, platform, and decentralized
Source of Economic Differentiation	Balances and deposits	Transaction fees	Relationship and transfer fees	Convenience, security, and low fraud incidence
Distribution Channels	Physical bank branches	Physical and ATMs	Physical, ATMs, online, mobile, and digital wallets	Physical, ATMs, online, mobile, embedded, and metaverse
Technology	Telegram	Automated clearing house (ACH)	Applications and instant payments	Platform as a service (PaaS), tokenization, generative AI, and open / API banking

Financial Technology for Ventures Breakdown



Customer Transaction Flowchart



Macroeconomic Drivers of Payment Processing



Economic Growth, Consumer Spending, & Velocity of Money

Inflation / Interest Rates

Globalization

➤ When there are periods of economic growth, consumer spending will spike, and the velocity of money will increase. With the increase of payment volume, there will be more fees for payment processors to collect. Consumer spending has been positive, but slowly growing in 2023.

➤ The current inflationary environment is causing the federal reserve to act hawkish and raise interest rates. When interest rates rise, the velocity of money decreases and consumers become more cautious. With inflation slowly subsiding, interest rates are expected to drop in 2024.

➤ As the world economy is becoming more connected, the flow of funds is starting to cross borders all over the world, unlocking a new total addressable market. Payment processors will need to start looking for opportunities abroad.

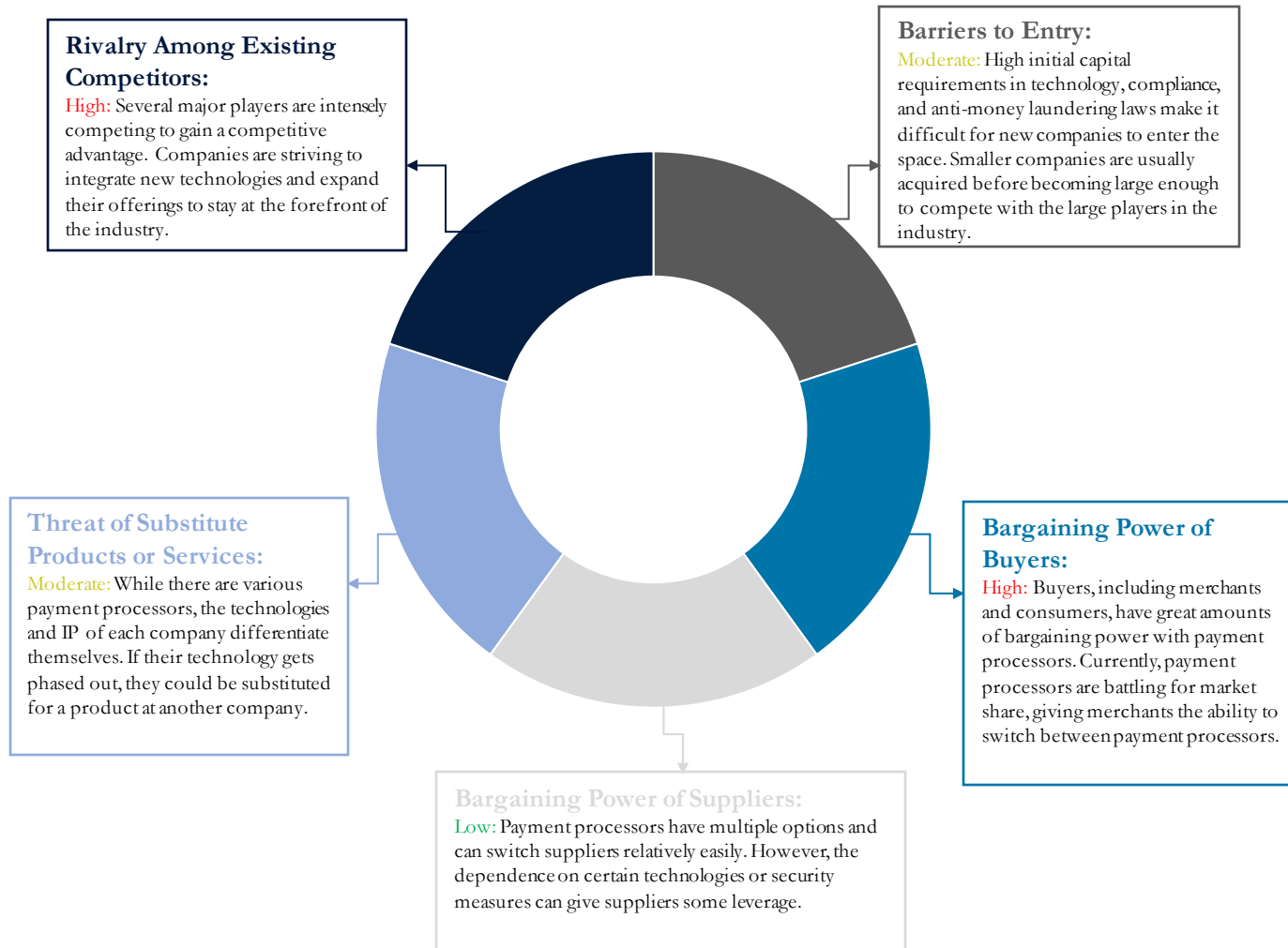


SWOT Analysis of Payment Processing



	Helpful	Harmful
	Strengths	Weaknesses
Internal	<ul style="list-style-type: none"> • Economies of Scale: following the initial startup expenditures and overcoming entry barriers, payment processors possess enhanced capabilities for scaling their products compared to other industries. • Innovation: payment processing companies are known for their innovative approaches and integrating artificial intelligence (AI) to enhance the payment processes. • Speed, Efficiency, and Cost-Effective Solutions: payment processors provide quicker and more efficient transactions with lower fees in comparison to conventional banking methods. • Accessibility: users can access payment services easily through digital platforms, making financial transactions more convenient. 	<ul style="list-style-type: none"> • Reliance on Card Networks: in every payment processing transaction, payment networks play a pivotal role. Payment processors are vulnerable to fees imposed by these networks. • Consumer Trust Concerns: any breach or perceived lack of trust with sensitive materials can have a detrimental impact. • Inadequate User Education: insufficient efforts to educate users on high-tech features and user interfaces.
	Opportunities	Threats
External	<ul style="list-style-type: none"> • Data Analytics: payment processing companies leverage data analytics to understand user behavior, enabling them to offer personalized and targeted solutions. • Strategic Partnerships and Vertical Integration: processors often collaborate with other companies and form ecosystems, providing users with a comprehensive suite of financial services beyond just payment processing. • Global Reach: many payment companies facilitate cross-border transactions, providing users with the ability to make payments internationally. • Blockchain and Cryptocurrency Integration: payment processing companies explore the use of blockchain technology and cryptocurrencies, offering decentralized and secure payment options. 	<ul style="list-style-type: none"> • Cybersecurity Vulnerabilities: payment systems may be susceptible to cyber threats, hacking attempts, and data breaches. • Regulatory Compliance Challenges: the rapidly evolving regulatory landscape can pose challenges for payment processors to stay compliant with various financial regulations. • Chargeback and Credit Fraud Risk: the escalating risk of chargebacks and fraud is compelling payment processors to invest substantial capital expenditures (CapEx) in combating these breaches.

Payment Processing Industry Porter's Five Forces Model





II. Differentiating Factors Between Payment Processing Companies



Intellectual Property within Payment Processing



Types of Intellectual Property

Fraud Detection Algorithms



Patented algorithms for detecting and preventing patterns of fraudulent transactions.

Tokenization Processes



Processors develop unique tokenization methods to secure sensitive payment data. Tokenization involves replacing cardholder information with encrypted data to reduce the risk of data breaches.

Biometric Payment Authentication



Patents cover innovations related to biometric authentication methods for authorizing payments, such as fingerprint recognition, facial recognition, or voice recognition.

Payment Data Analytics



Intellectual property involves proprietary methods for analyzing payment data to develop insights into customer behavior, market trends, cash flow analysis, and other important metrics.

Payment User Interface Design



Patents cover unique and user-friendly interfaces for payment processing applications and data analysis.

Key Differentiating Factors Between Payment Processing Companies



Functionality and Integration of SaaS Offerings with the “CFO Stack”



Payment processors who offer technologies that automate AP/AR, inventory, payroll, and other types of management systems will gain a competitive advantage over peers.

Data Analysis Capabilities and User-Friendly Interfaces



Processors with user interfaces and other product offerings will be able to seamlessly integrate the automated systems to generate easy to use reports to give merchants up to date business metrics.

Cross-Border Payment Services and Crypto Offerings



Enhanced cross-border payment capabilities can increase payment volumes and capabilities globally to increase significant TAM.

E-Commerce solutions and credit gateways



Payment gateways allow for companies to process e-commerce transactions from customers.

Range of payment methods



Methods include POS systems, mobile payments, prepaid cards, e-checks, invoices, QR codes, online payments, ACH payments, wire transfers, etc

Support



Availability of support for network crashes and other problems that may arise.



III. M&A Trends in Payment Processing



Expanding into the “CFO Stack”



Data Analytics

- Integration of a payment processor and AP automation system ensures the seamless flow of AP/AR to give a more holistic view of the financial health of a company.
- Companies who make data driven decisions will experience increased efficiency and more effective decision making.
- The enhancement of reporting processes leads to the creation of detailed, analytical reports to help companies make data-driven decisions.
- Data can be filtered by category, supplier, time-period, and geographic location to give them an edge against their competitors in this rivalrous environment.

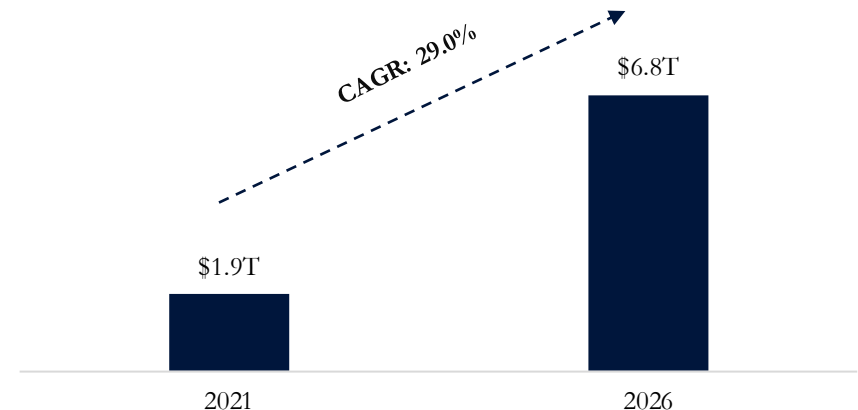
Statistics about AP Automation and B2B Payments

47% of CEOs Say Efficiency Drives their Decision Making	59% of Companies Say They Have Fewer Errors with Automated AP	82% of Small and Medium Sized Businesses (SMBs) are Changing How They Process and Receive B2B Payments
29% CAGR Growth of Global Virtual Cards Payments Between 2021 and 2026	71% of All Global B2B Payments Will Be Done With Virtual Cards by 2026	\$6.8T in Global Virtual Card Payments is Expected in 2026

Virtual Card Overview






- Virtual Cards are efficient, secure, and will increase the volume of B2B transactions.
- These cards have become very popular and are expected to grow at a CAGR of 29% due to seamless integration with AP automation systems.
- ACH debit accounted for 34% of payment fraud in 2020, while virtual cards accounted for a mere 3%.
- B2B should consider incorporating virtual cards into their daily operations to decrease fraud, improve vendor relationships, and provide more insight into companywide spending.

Growth in Global Virtual Card Payments



Payment Processing M&A Transactions with “CFO Stack” Integration



Acquisition Date	Seller	Acquirer	Deal Size	Summary
Mar-23		globalpayments	\$4,000MM	Global Payments strategically acquired EVO to penetrate into the B2B payments market, significantly increasing their TAM potential. The acquisition also opened the door to enter the AP/AR automation space and offer virtual card solutions for businesses. Additionally, Evo is the leading payment integration provider for Microsoft Dynamics.
Aug-22			\$140.7MM	Fleetcor strategically acquired Accrualify to expand into the AP automation software space. This acquisition is expected to increase demand and revenue per customer. The comprehensive, cloud-based Accrualify software platform provides middle market companies full end-to-end procurement and invoice process automation as well as payments execution.
Mar-22			\$90MM	Brex Acquired Pry to expand its software capabilities for founders. Pry is a financial planning platform that essentially replaces Excel for founders, helping them plan and manage budgets, create hiring plans, and build financial models. Much like AP/AR automation, Brex acts as the payment processor and Pry acts as the software plug-in that integrates into many types of accounting and payroll software.

Globalizing the Payment Processing Industry



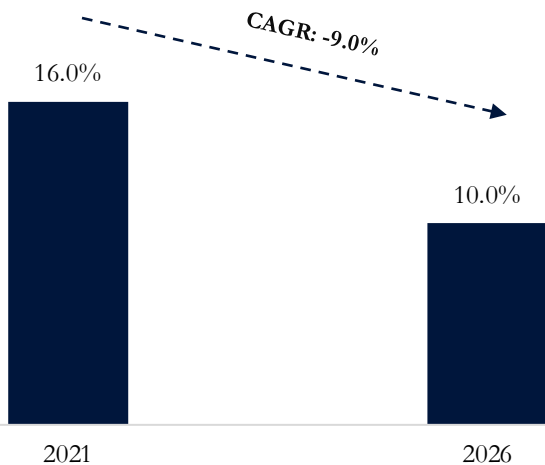
Expanding TAM Potential

- As the global payment processing industry grows, payment processing companies are looking to engage in M&A activity to expand their TAM potential and reach into new markets.
- 71% of the total addressable payment processing market is outside of North America, forcing companies to look outward.

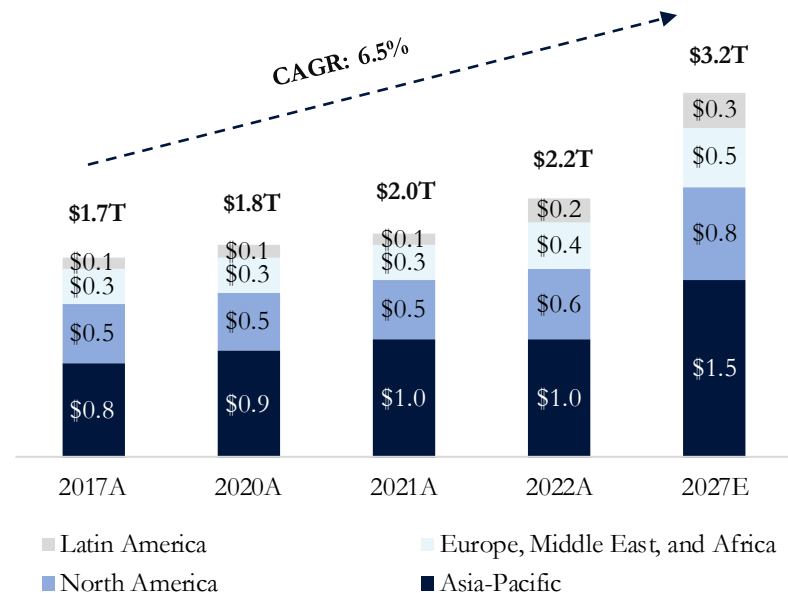
Trends in Global Payment Revenues

- The world is moving away from cash and towards credit processing, driving revenue from fees for credit processors.
- Global Payments revenue is expected to grow at a CAGR of 7% between 2022 – 2027.
 - Asia-Pacific: 8% CAGR
 - North America: 6% CAGR
 - Europe, Middle East, and Africa: 6% CAGR
 - Latin America: 11% CAGR

Percent of POS Transactions Paid with Cash





Global Payments Revenue 2017 – 2027E



Payment Processing M&A Transactions with Globalization Strategy



Acquisition Date	Seller	Acquirer	Deal Size	Summary
Mar-23		globalpayments	\$4,000MM	As mentioned before, there was a strategic element and globalization element to this transaction. Global payments also wanted to expand their global footprint into Poland, Germany, Chile, and Greece while also expanding their current presence in the United States, Canada, Mexico, Spain, Ireland and the United Kingdom.
Nov-22	MERCHANT ^{TE}	 opn	\$375MM	Opn acquired MerchantE to expand into the U.S. payment processing market. Opn has been offering services mainly in Southeast Asian countries such as Singapore and Thailand. With the acquisition, Opn's global footprint now spans seven countries, including the U.S., the largest growing market for embedded finance solutions, which is expected to more than double to over US\$50 billion by 2026, significantly increasing TAM potential.

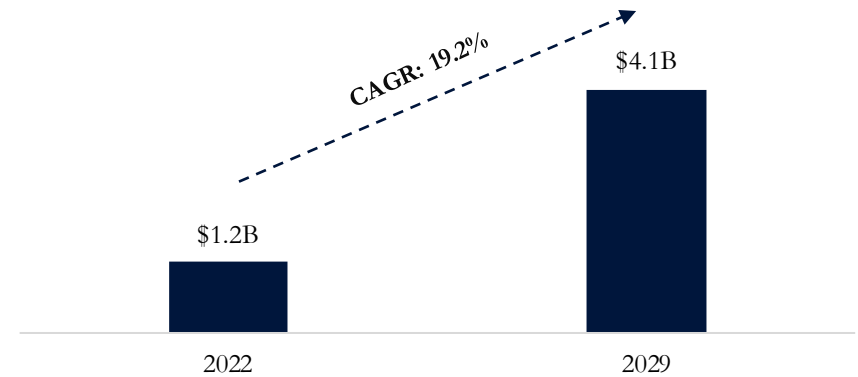
Expanding into Crypto and New Industry Verticals



Cryptocurrency

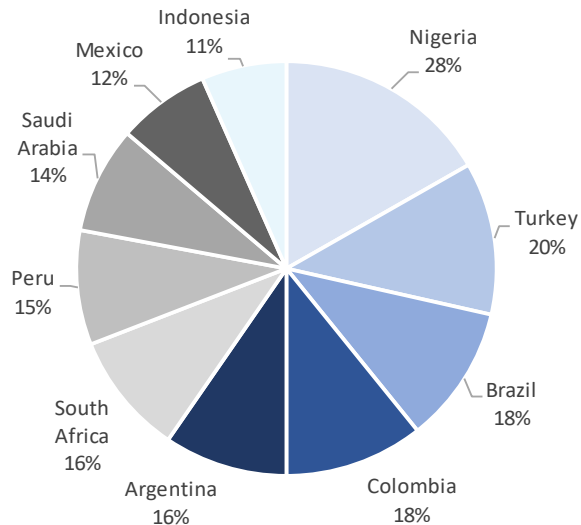
- Cryptocurrency is an alternative payment method that does not operate in the same capacity as traditional payment processors.
- Across the globe, cryptocurrency is a major player in some countries since it acts as a decentralized currency which provides beneficial in a situation where paper currency in countries is highly volatile or where there is low trust in government.
- In the event where traditional payment processing methods are not suitable for a particular country, payment processors must explore the option of adopting and setting up the infrastructure for their merchants to accept cryptocurrencies domestically and abroad.

Market Size of Crypto Payments within Payment Gateways

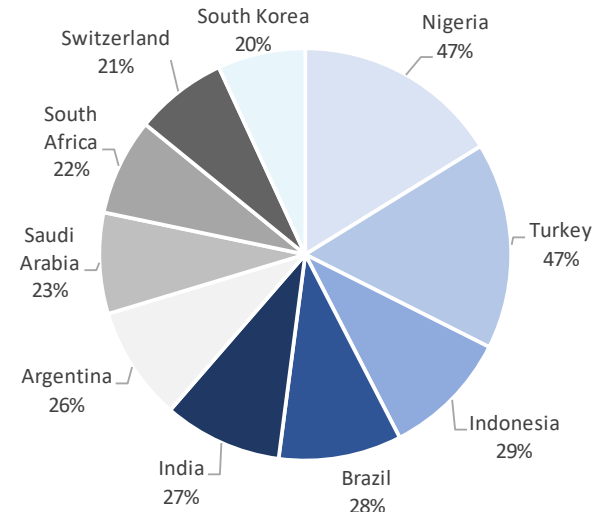


Shifts in Worldwide Crypto Adoption

2019A



2023A



Payment Processing M&A Transactions with New Vertical Strategy



Acquisition Date	Seller	Acquirer	Deal Size	Summary
Feb-22	 The Giving Block <small>A SHIFT4 COMPANY</small>	 Shift4 PAYMENTS	\$106.9MM	Shift4 Payments acquired the Giving Block with the goal of increasing payment volumes in the crypto space. Due to the Giving Block specializing in crypto donations to over 1,300 nonprofits, they have the expertise and infrastructure to accept crypto payments. By the two companies joining, Shift4 immediately can bring crypto offerings to their 200,000+ merchants.



IV. Other Representative M&A Transactions



Strategic M&A Activity within Payment Processing



Acquisition Date	Seller	Acquirer	Deal Size	Reason for Acquisition	Summary of Acquisition
Nov-23			\$250MM	WEX's wants to expand its product suite by creating cross-selling opportunities by providing a new, scalable SaaS solution for its approximately 150,000 small business customers. Payzer's top-tier service offering is at the convergence of SaaS and payments.	Expansion into new sectors; combining SaaS and payment abilities
Mar-23			\$4,000MM	Global Payments wanted to expand its footprint to Poland, Germany, Chile, and Greece and enhance its scale in existing markets, including the United States, Canada, Mexico, Spain, Ireland and the United Kingdom. It also allowed for them to enter into the AP automation space.	Global Expansion / Integration with "CFO Stack."
Feb-23			\$1,300MM	Paya amplifies Nuvei's existing growth strategy and expands its reach into new underpenetrated and non-cyclical verticals where Nuvei's proprietary technology is well positioned to accelerate customer growth.	Expansion into new sectors and increase payment volume
Nov-22			\$375MM	Japanese company, OPN, wanted to enter U.S. online payment sector.	Global Expansion
Aug-22			\$140.7MM	Fleetcor wanted to expand into workflow and process automation software that AP departments are looking for, leading to an increase in demand and revenue per client.	Expansion and integration with "CFO stack"
Mar-22			\$90MM	Brex wanted to expand its software capabilities for founders. Pry is a financial planning platform that essentially replaces Excel for founders, helping them plan and manage budgets, create hiring plans, build financial models, predict cash runway, and more.	Expansion and integration with "CFO stack"
Feb-22			\$106.9MM	Shift4's wanted to increase payment volume and expand into the crypto and nonprofit sectors. More than 200,000+ of their merchants now have access to crypto payment offerings.	Expansion into new sectors and increase payment volume
Feb-22			\$209MM	TriNet wanted to expand its product offering to become a human resources services provider for small and midsize businesses with or without the professional employer organization structure.	Expansion and integration with "CFO stack"

LBO Activity within Payment Processing



Acquisition Date	Seller	Acquirer	Deal Size
Jun-23		 MADISON DEARBORN PARTNERS, LLC	\$1,800MM
Feb-23		   	\$8,000MM
Apr-22			\$143MM
Aug-22			\$455MM
Mar-21		 Thomas H. Lee Partners	\$551.2MM
Sep-20			\$1,000MM
Dec-19		 ACCEL-KKR	\$93.55MM
Feb-19		 EQUITY PARTNERS	\$1,900MM



V. Future Trends

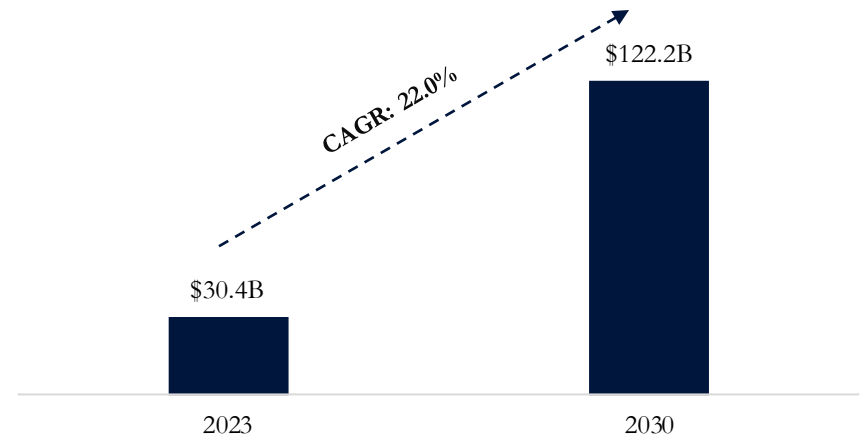


Partnering with Buy Now Pay Later (BNPL) Platforms

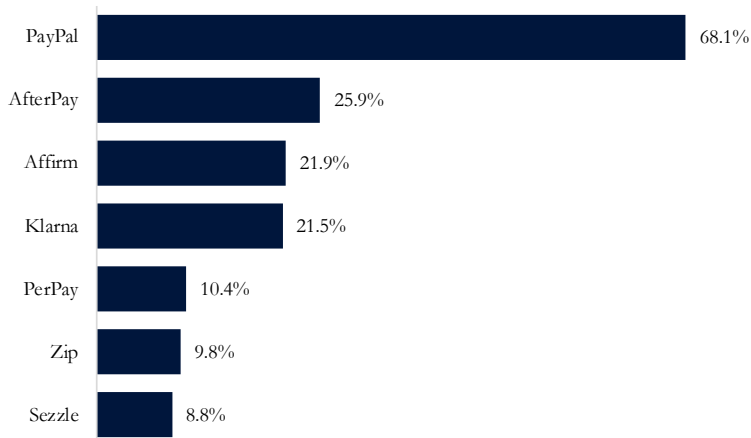
BNPL Integration Overview

- The increasing number of e-commerce platforms, and rising services adoption across millennials in developing countries, have propelled the global BNPL market.
- Retailers report as much as a 50% increase in average order value, and 2-3x more units per transaction from the integration of a BNPL platform.
- Payment processing companies will need to have a BNPL offering to merchants who have a strong e-commerce presence.

The Global BNPL Market is Expected to Reach \$122.2B by 2030



% of BNPL Customers who have used the Following Platforms



Top BNPL Partners



Getting Ahead of the Generative AI Transformation



The Move from Predictive AI to Generative AI will Transform the Integration between Payment Processors and the “CFO Stack.”

Predictive AI

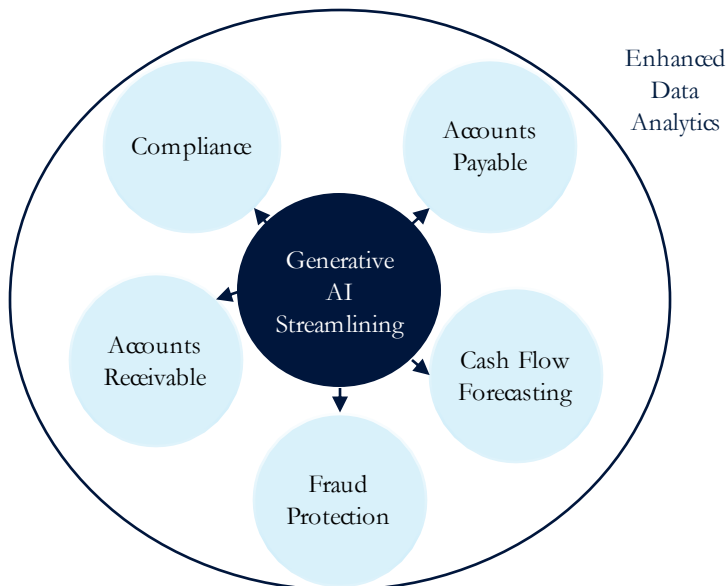
- Predictive AI models know about the world, but have trouble generating specific plans for your business.
- Payment processors are acquiring SaaS companies for the purpose of AP automation and data analytics.
- The data being produced is extremely helpful and will set companies ahead, but generative AI will push this to a new level.



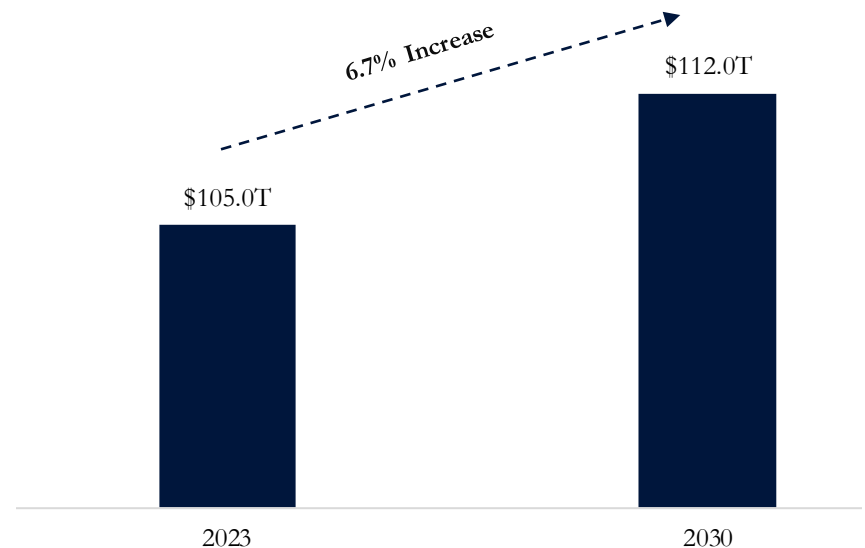
Generative AI

- Generative AI models fine tune data for individual businesses.
- Creates original content such as text, images, audio, code, and video which, at the moment, requires human skill to create.
- Can add contextual awareness and human-like decision-making to enterprise and finance workflows.
- Powered by foundation models, which run on deep-learning algorithms modeled on the organization of neurons in the human brain.
- Companies need to be in tune with the VC landscape to potentially integrate and be at the forefront of this revolutionary technology.

Generative AI Applications in Payment Processing



Increase in Worldwide GDP from Generative AI





VI. Summary



Summary



- The payment processing industry is here to stay, growing at a CAGR of 6.5% and expected to reach a total of \$3.2T by 2027.
- The industry is being driven by the global trend of moving towards a cashless society and the increased demand for automation across the CFO stack.
- In order to strategically position themselves, companies in the industry are engaging in M&A:
 - Integration with the CFO stack will help with automation and data analytics creating an all in one payment processing solution.
 - Expanding globally
 - Expanding their reach to new industry verticals such as cryptocurrency.
- In the future, CEOs need to navigate this fast-growing industry.
 - Invest in generative AI companies and stay in tune with the VC landscape.
 - Partner with buy now pay later models to increase offerings to merchants.
- The payment processing industry is a tough market to navigate, but with the correct advisor, companies will experience success and stay at the forefront of innovation in this fast-growing and evolving market.

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