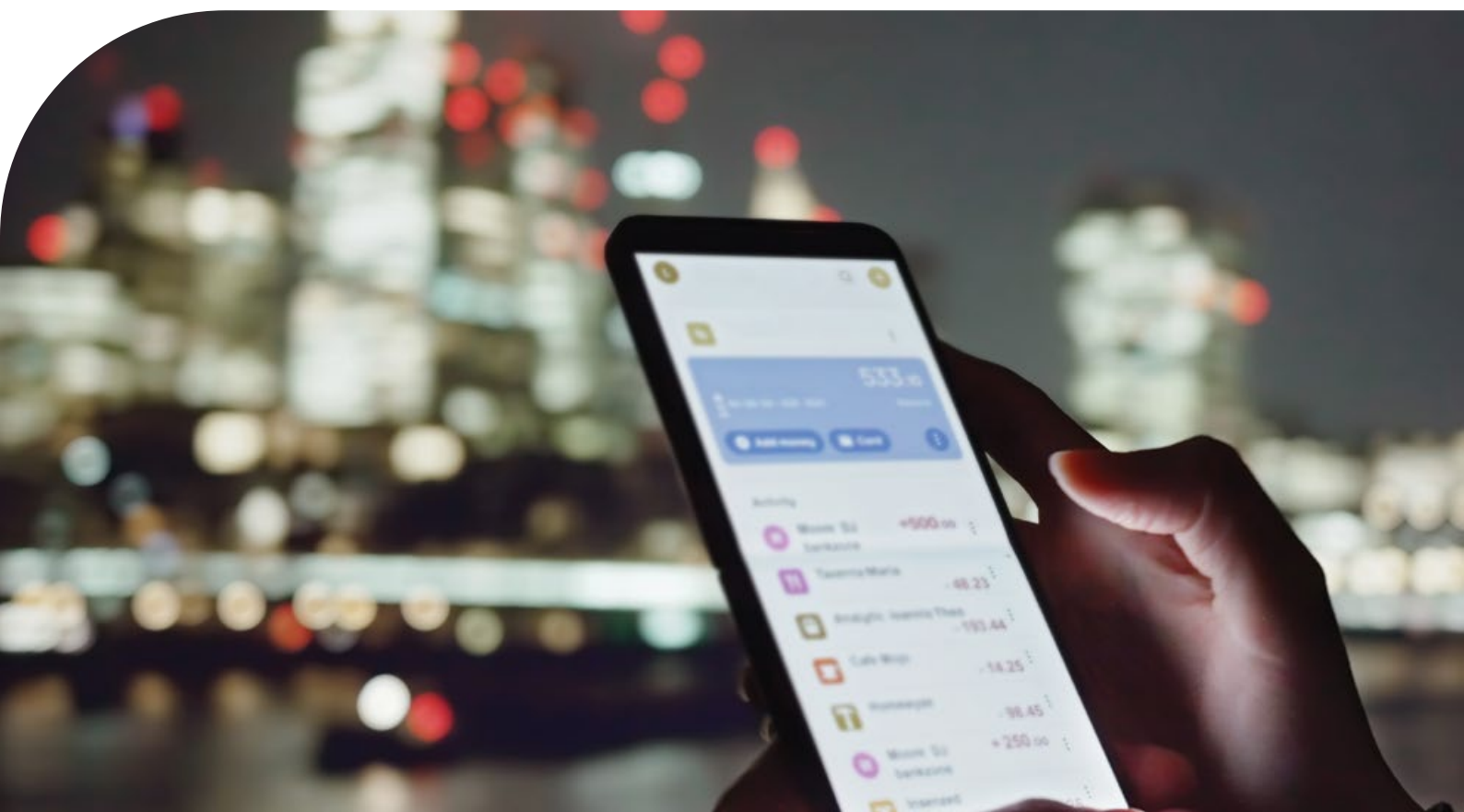


JUNE 2024

UK SMALL CAPS: TRANSFORMATIVE TRENDS

THREE DISRUPTERS TRANSFORMING THE DIGITAL ECONOMY

Portfolio Manager, Dan Green taps into four key long-term investment themes where pioneering goods and services are an emerging trend: The **digital economy**, consumer brands, content & intellectual property (IP) creation and decarbonisation. In the third instalment in our four-part series, he draws attention to the evolving digital landscape and those companies that stand to benefit from it.





Dan Green, CFA

Portfolio Manager
& Research Analyst

- Digital wallet payments are the most popular form of e-commerce payment worldwide
- Technology solutions are needed to help businesses onboard customers in a safe and efficient manner but without compromising the user experience
- The pandemic has transformed the auction industry and accelerated the move from in-person physical events to online auctions



The Digital Economy



Consumer Brands



Content and IP Creation



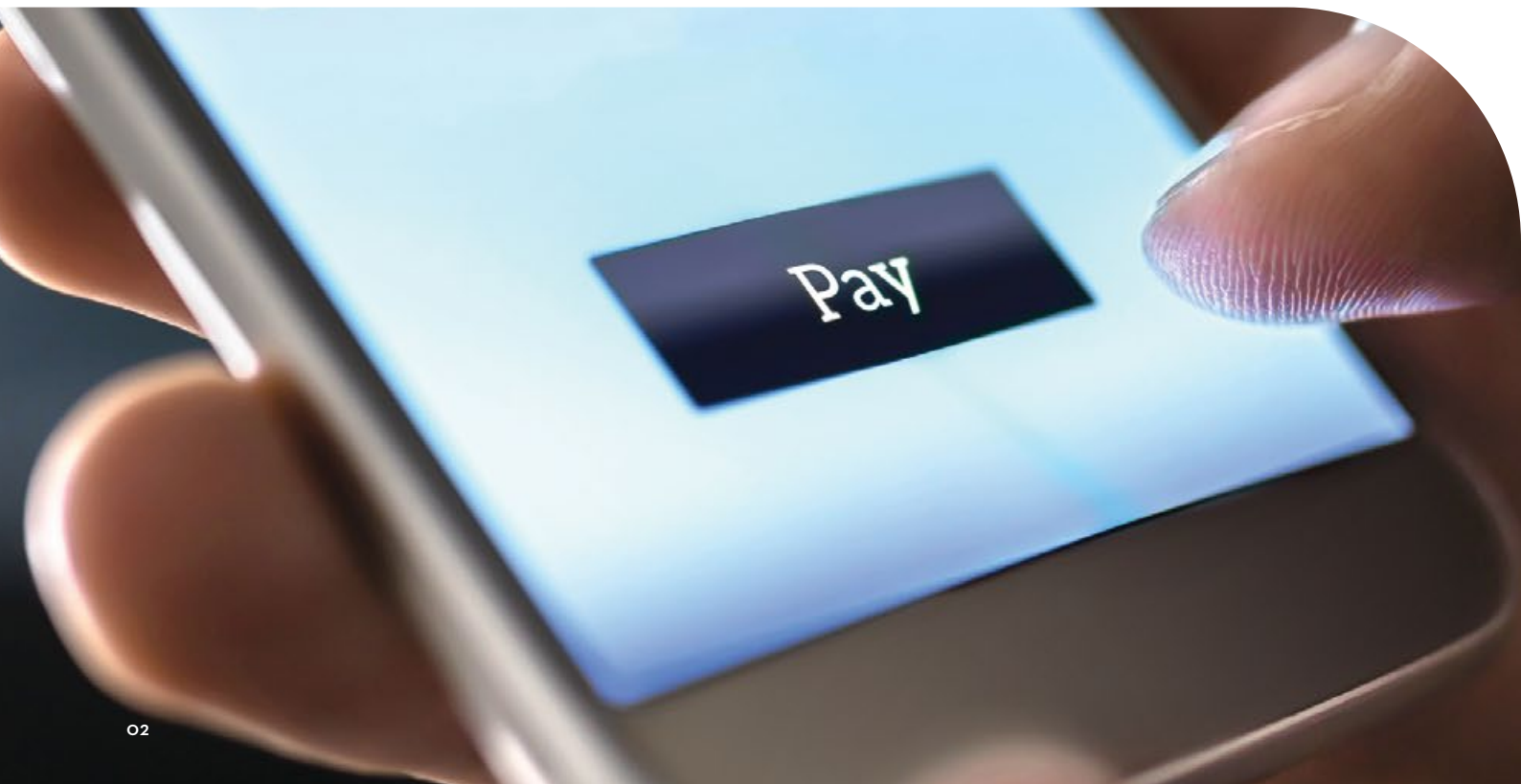
Decarbonisation

Future of the digital landscape

It will be no surprise to anyone that the digital economy, made up of companies generating income from online activity, will be a significant driver of the UK's economic growth over the coming years. What is less appreciated, and certainly interesting, is the scale of its impact. It is estimated that by 2040, UK Gross Domestic Product (GDP) will be nearly 7% higher than baseline GDP if increased investment in digital technology persists¹. We are excited by some of the hidden digital economy gems that can be found in the UK small cap sector. These innovative technology companies operate in a quickly evolving area of the market with the potential to become global leaders.

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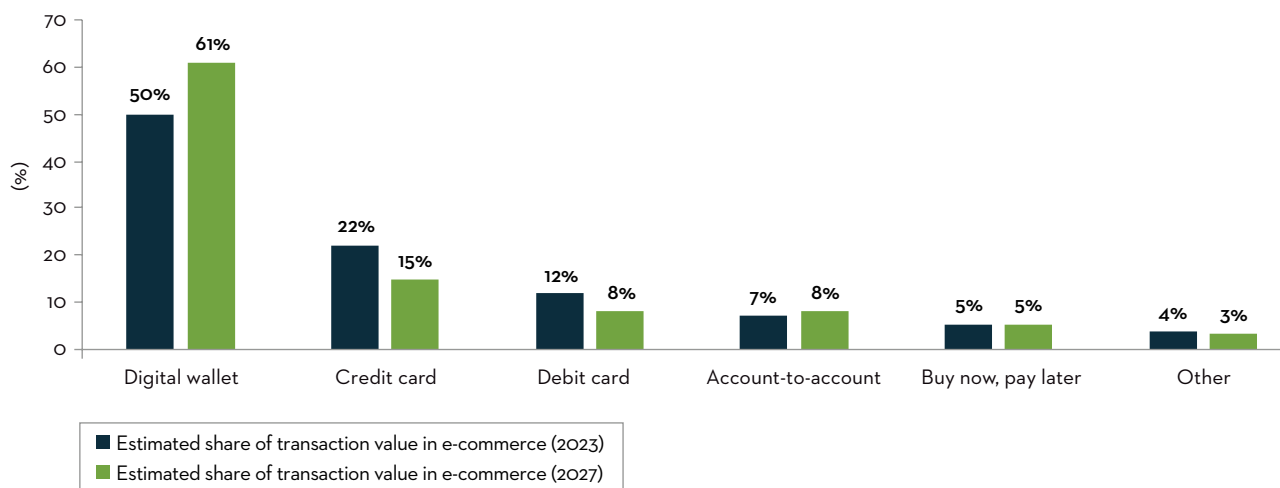
¹Source: Statista, Virgin Media; CEBR as at 31 May 2022. GDP growth from investment in digital technology in the UK 2020-2040.



Evolution of payments

Digital payments business Boku has developed and operates a platform that connects merchants with alternative payment methods. Their customers include some of the largest digitally focussed businesses in the world such as Microsoft, Meta, Alphabet, Netflix, Apple, Spotify and Sony. The firms partner with Boku to make connections to different payment methods to enrol more customers and sell more of their products. While alternative payment methods such as direct carrier billing, where services are paid through the monthly mobile phone bill, or local payment methods such as digital wallets (e.g. Apple Pay and Google Pay) are still emerging payment systems in the UK. On a global basis they make up the majority of payment methods. In the UK, debit and credit cards made up 47% of online payments by value in 2023, with digital wallets making up only 38%. You see a similar pattern in the US. However, looking at these statistics globally, digital wallets make up to 50% of online payments due to their popularity².

Share of E-commerce payment methods worldwide in 2023 and forecast 2027



Source: Worldpay; GlobalData; McKinsey & Company; World Bank; IMF; Statista as at March 2024.

The importance of Boku's offering was demonstrated by its customer Netflix's results. When discussing growth in subscriber numbers, Netflix said "the number of new members signing up last year using alternative payment methods more than tripled"³. Boku has also won a tender against a much larger digital payment company to roll out local payment methods for Amazon globally. Starting in a few territories for digital services but with scope to grow into physical e-commerce products and other Amazon services. If Boku can expand into physical services from offering solutions to digital services, the target addressable market goes from the billions to the trillions of dollars.

The business made strong profit margins of over 30% on the \$83 million revenue generated in 2023⁴. At the company's 2023 Capital Markets Day, they set an ambition over the medium-term of doubling revenue and having a 50% profit margin⁵. We believe the targets are very achievable as the company is just in the foothills of rapid and profitable growth. We share the CEO's enthusiasm for the potential of the business, when in the financial year 2023 results he said "If we get this right, Boku could be a rocket ship and to quote a Pixar classic, to infinity and beyond"⁶.

“ If Boku can expand into physical services from offering solutions to digital services, the target addressable market goes from the billions to the trillions of dollars. ”

²Source: Worldpay as at 2024. The global payments report

³Source: Netflix as at June 2022. Beyond Cards: Giving Members More Ways to Pay

⁴Source: Boku as at 19 March 2024. Audited Results for the year ended 31 December 2023.

⁵Source: Boku as at 21 February 2023. Capital Markets Day 2023. <https://investors.boku.com/boku-capital-markets-day-2023/>

⁶Source: Boku as at 31 Dember 2023. 2023 Annual Report.

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Solutions to tackle bad actors

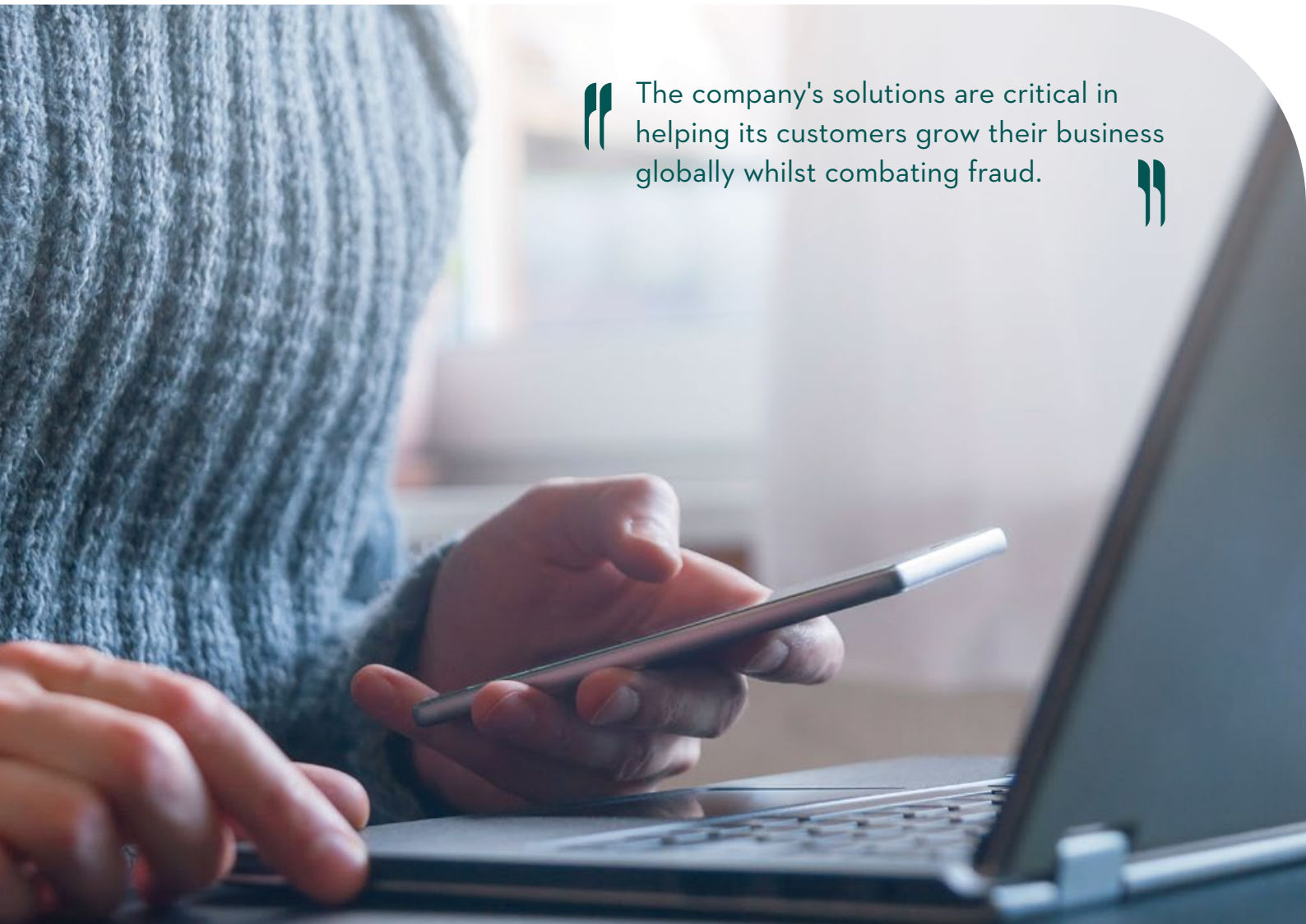
The continued growth of the internet and e-commerce has meant businesses are dealing with more customers online than ever before and the data being created from these transactions is ever increasing. Technology solutions are needed to help businesses onboard customers in a safe and efficient manner but without compromising the user experience. This can be achieved through verifying addresses effectively to support e-commerce volumes, combating fraud and mitigating risk not just at the onboarding stage but through the customer lifecycle. Additionally, with more and more personal data being created, regulation has increased alongside this to ensure customers are protected. These developments have created a highly favourable market dynamic for GB Group's solutions who provide identity verification, location intelligence and fraud prevention software.

The company reported a slowdown in growth, after some very strong years where demand has been driven by crypto and internet-economy customers. We felt the downturn in demand was cyclical and the structural drivers of growth were still in place for GB Group to grow over the long-term. The company's solutions are critical in helping its customers grow their business globally whilst combating fraud. The scale and cost of the problem are only growing bigger, with artificial intelligence (AI) also being deployed by bad actors (e.g. deepfakes) and the regulatory environment getting more onerous. The company has over 30 years of experience⁷ and a capability developed in the space by helping customers in over 70 countries⁸. This is another example of a UK listed business at the forefront of emerging global trends in the digital economy, in an industry which has seen a lot of corporate activity.

⁷Source: GBG as at 2023. Building trust in a digital world. Annual report and accounts 2023.

⁸Source: GBG as at 31 May 2024. Our History. <https://www.gbgplc.com/en/investors/who-we-are/our-history/>

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“ The company's solutions are critical in helping its customers grow their business globally whilst combating fraud. ”

Digital evolution of the auction industry

The Auction Technology Group (ATG) is the global market leader in operating marketplaces that enable independent auction houses to connect with bidders worldwide, and is at the forefront of transforming the global auction industry. In addition, through the onward sales of second-hand goods, the company supports making a more circular economy. The Covid-19 pandemic has transformed the auction industry and accelerated the move from in-person physical events to online auctions⁹.

Growth is largely driven by the structural shift of physical auctions to online with ancillary services improving ATG's end-to-end offering as well as its take rate. We like the network effects of the business model where the dominant platform attracts the most bidders and therefore the most auction houses and vice versa. ATG has a leading market position in the Arts & Antiques and Industrial & Commercial markets in the UK, USA and Germany. Accelerated by the pandemic, the adoption of online auctions has proven the benefits of ATG's proposition with access to a global pool of bidders, often increasing the price for the seller and thus the commission for the auctioneer. We believe that the market is still in the early development phase of the online transition. ATG is following a well-defined playbook used by other dominant players in industries such as automotive and real estate by expanding the range of services to its customers by offering payment, shipping and marketing solutions. The structural growth in this industry should underpin earnings growth for many years with ATG expanding its competitive position over its rivals in recent years. We believe that ATG will continue to extend its lead in a 'winner-takes-all' global market, becoming the default choice for auction houses wanting to access the largest pool of bidders by migrating to digital auctions.

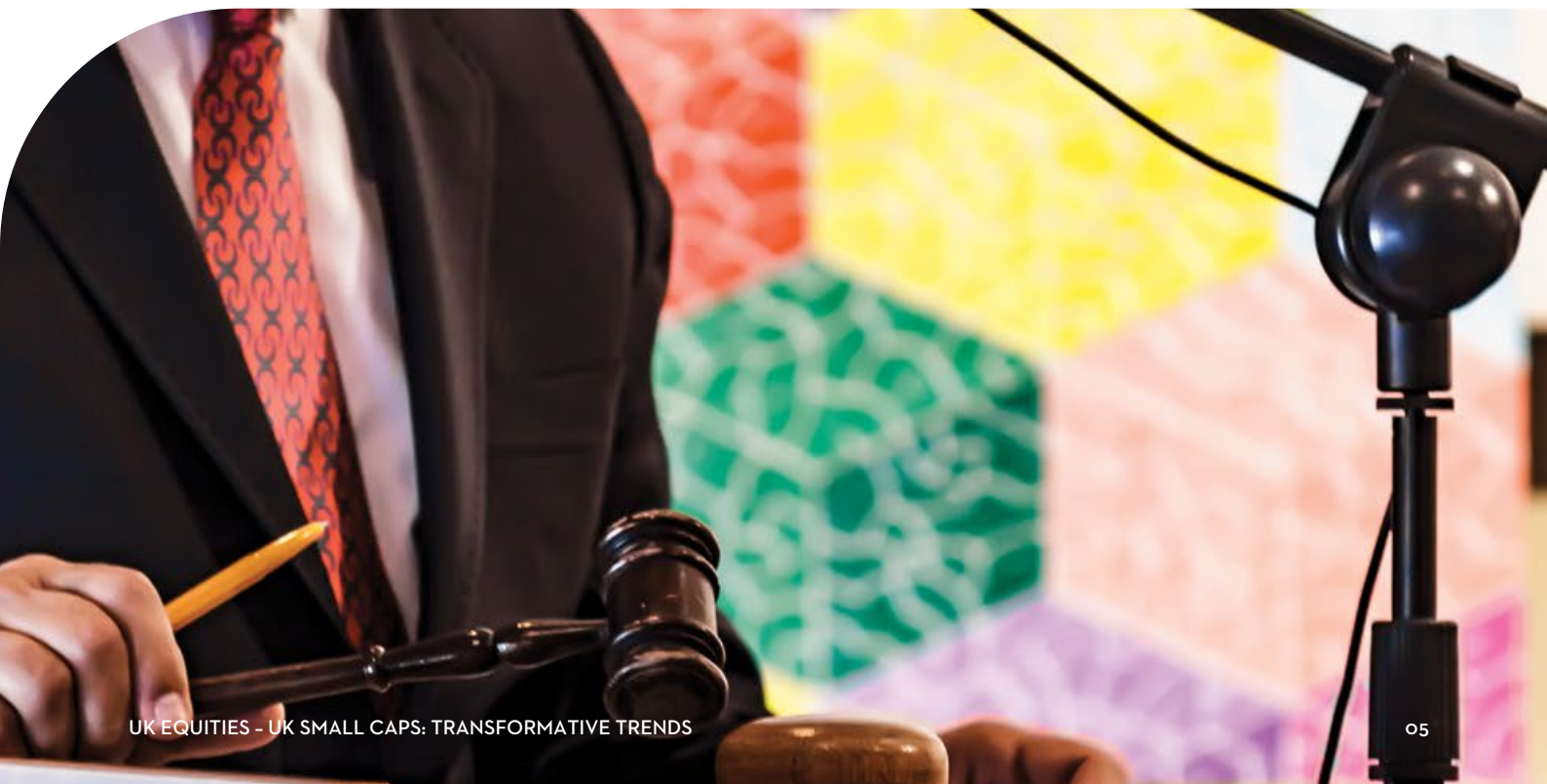
“ ATG has a leading market position in the Arts & Antiques and Industrial & Commercial markets in the UK, USA and Germany. ”

Shifting structure

The structural shift to a digital economy underpins our conviction in these names. Offering unique exposure to exciting and emerging businesses, we believe that UK small caps are becoming an increasingly attractive option for investors.

⁹Source: Auction Technology Group as at 2023. Unlocking the value of the curated secondary goods market.

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- This strategy may hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the strategy's value than if it held a larger number of investments.
- Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.