

April 23, 2012

**How MasterCard Incorporated (NYSE: MA) and Visa, Inc. (NYSE: V)
Are Driving Cash out of Business**

Part Two

**ANDREA AMBITIOUS FINDS THAT HER VISA DEBIT CARD
GETS HER INTO THE NEW YORK CITY SUBWAY SO THAT SHE CAN KEEP HER
APPOINTMENT ON TIME WITH A WEALTHY HEDGE FUND MANAGER CLIENT AND
BEGIN CHARGING HER HIGH BUT WELL-DESERVED HOURLY RATE**

Friday, November 11, 2011. New York City. 7:40 A.M.

Andrea Ambitious, a fictional name but a real character, a recently divorced mid-forties attorney, looked at her full-length mirror one last time, checking her hair, applying some lipstick, and making sure that the buttons on her suit jacket that were buttoned were supposed to be buttoned, and that the buttons that were unbuttoned were supposed to be unbuttoned.

She stepped back and took a final appraisal, confident that her look would broadcast this message: she was a woman, an attractive woman, but most importantly she was a professional woman who knew where she was going, how to get there, and that she did not have to be offensively aggressive to get what she wanted. Her understated but assertive style has propelled her to respectable levels of compensation and status, levels, she was confident, that would continue to rise as the firm's compensation committee and her senior partners and her clients continued to recognize her analytical competence and her emotional intelligence.

It is a crisp sunny morning, the kind of morning that seems to acknowledge the energy of the city. After exiting her apartment, 16B at 11 Charlton Street, a two-bedroom unit that she had bought earlier in the year for \$1.5 million, one that came with a twenty-four hour doorman, an in-building laundry, and a good view of the west, as well as a steep \$1,331 monthly maintenance fee, she walks to the elevator. Soon she is in the building lobby, greeted by the alert doorman who opens the building door for her, offering to get a taxi for her, an offer he knows she will refuse. (He knows that she believes that if you are a streetwise New Yorker, the subway is often the fastest way around the clogged, treacherous streets of the city.)

INVESTMENT LETTERS WITH NO SOPORIFIC JARGON

Just the facts, ma'am. No soporific jargon, no wordy, vacuous analysis, but clear writing with pertinent facts consistent with a commonsense investment strategy, the product of a culture that prizes constructive intellectual challenge and the non-stop exchange of investment ideas that bright, energetic, and personable colleagues produce. We have not forgotten what is most important to our clients: outstanding investment performance. We have consistently achieved annual returns, net of fees and expenses, markedly greater than the annual performance of the Standard & Poor's 500.

**ANDREA KNOWS THAT TIME IS PLASTIC AND PLASTIC IS KING
(OR QUEEN, IF YOU'RE A FEMINIST)**

Now walking to the Spring Street subway entrance, only a one or two minute walk away, *Andrea* is already planning her 8:15 a.m. meeting at the three hundred person law firm where she works, Cahill Gordon & Reindel LLP.

She paid a lot of money (though she knows she got a good deal) for her condominium so that she could be in the trendy Soho district, have all the amenities her building offers, and have an array of shopping and other services within convenient reach, and she deems the purchase shrewdly efficient as it is her feeling, endorsed repeatedly by the written commentaries of the firm's compensation committee, that her career trajectory is steeply positive, and will get more so. The building's location is highly convenient, saving energy and time, and with her hourly billing rate, she believes she has made a great investment. Above all, she knows that **time is plastic**.

Investment Thesis: MasterCard Incorporated (NYSE: MA) and Visa, Inc. (NYSE: V)

1. **MasterCard** and **Visa** operate in the global payments industry, an industry which is enjoying a powerful secular shift toward card-based and other electronic forms of payment, moving away from paper-based payments, such as cash and checks. The practice of payment with plastic took hold in the 1960s in the United States, and here the practice of using credit and debit cards to pay for purchases is widespread and may have reached its peak. Yet even in so-called "mature" payment markets such as the United States, Western Europe, and South Korea, more than half of personal consumption expenditure is effected using paper, and in the rest of the world there is no doubt that plastic payment usage is a long way from its peak. Its better days are only beginning. **In fact, only fifteen per cent of consumer transactions of the annual \$15.7 trillion in the world are done through debit or credit card. Cash or check account for the other eighty-five per cent, suggesting a significant global opportunity for MasterCard and Visa.**
2. When you combine, respectively, the **MasterCard** and **Visa** networks with the brand power of each company, you have two formidable competitors. It would take many billions of dollars and years of cultivation with merchants and banks to make much of an inroad in to the **MasterCard** and **Visa** systems, to challenge their brands, to ask consumers and merchants to even consider a different way of making payments. In my opinion, this would be an incredibly difficult proposition, a challenge that most businessmen would view as not worthy of payoff, with tremendous obstacles, extremely unlikely to succeed. If these businessmen were asked off the record to give their opinion on the likelihood of supplanting the **MasterCard** and **Visa**, brands, they would turn each way to make sure no one was looking, and then they would say "**impossible**."
3. I like to think of **MasterCard** and **Visa** as software companies, as well as marketing companies. Once **Microsoft Corporation (NASDAQ: MSFT)** had developed its operating system, it turned out hundreds of millions of its copies that required little production cost, and the company's profits soared. Just as **Microsoft's** profits took off once it had established its software, the same is true of the two payment companies. They are software companies with extremely favorable operating leverage.

MasterCard has developed its software like **Microsoft**, spending huge amounts of dollars on research and development to build its system. The system is capable of handling much more business every year, meaning huge percentage increases in revenue, without having to invest the same percentage increase in expanding and maintaining its electronic superhighway.

Unlike the Turner Turnpike or the New Jersey Turnpike or our interstate highway system, roads that require significant and continuous cash outlays, outlays that rise as fast as the increased revenue that the roads produce as they serve more cars and trucks, the **MasterCard** and **Visa** highways require little upkeep in comparison with the yearly increases in revenue that they produce.

That is what I call the good kind of leverage: small increases in outlays and big increases in profits. That is my kind of leverage, unlike the leverage—that is the significant and often crushing amount of debt—that brought down **Lehman Brothers** in 2008 and **MF Capital (MF Global Holdings Ltd. (MFGLQ.PK))** in 2011, pushing both companies into bankruptcy.

To read the full Investment Letter, please email us at contact@ferimc.com or call (918) 743-5959. You could also fill out your contact information at <http://www.ferimc.com/contact.html>, we will contact you as soon as possible.