

## REPORT REPRINT

# ACI Worldwide positioned as an enabler for digital transformation in payments

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ACI Worldwide provides payments and banking software products and services across a variety of industries. It should see increased opportunities as retailers and enterprises seek to modernize their payments infrastructure for the digital world. In this report, we share updates on ACI's strategy, as discussed during its November 2017 Analyst Day.

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## THE 451 TAKE

ACI goes to market with its 'any payment, every possibility' proposition, a tagline that underscores its commitment to providing customers with the capability to orchestrate commerce across a growing number of payment methods and endpoints. The company finds itself in a unique position as banks, merchants, billers and other enterprises increasingly look to bring their dated core payments infrastructure up to speed with the digital world. ACI is realizing mounting benefits from continued investment in its modern payments platform that brings real-time capabilities and enhanced operating efficiencies to a variety of constituencies across the value chain. Moving forward, we expect ACI's prospects will continue to brighten as trends for which the company is well positioned, such as real-time payments and IoT, gain further traction in the marketplace.

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## FINANCIAL

ACI completed Q3 with \$226m in revenue (up 3% Y/Y), with recurring revenue comprising 76% of the total. Net income reached \$3m, or \$0.03 per share, and adjusted EBITDA grew to \$47m, up 34% Y/Y. New bookings totaled \$143m in the quarter and the company expects full-year 2017 new bookings growth in the high single-digit range. ACI has slightly updated the lower end of its revenue guidance for 2017, from a range of \$1bn to \$1.025bn to a range of \$1.010-1.025bn.

## INNOVATION AND ROADMAP

ACI provides both on-premises and cloud-based payments offerings, which it believes are differentiated in the market by characteristics such as capacity (e.g., 2,000 transactions per second), availability (e.g., 99.999% uptime) and scalability. The on-premises side of its business, where ACI's products are installed in its customers' datacenters, operates on a term software model. This is a cash cow for ACI, with \$600m in revenue and \$300m in EBITDA anticipated for 2017. On-premises customers, which are primarily banks and financial intermediaries, have very low attrition rates and entail low fulfillment costs. ACI's ability to layer on new license and maintenance revenue will be an important factor in driving continued profitability with its on-premises customers.

In 2016, ACI introduced its UP Retail Payment Solution (RPS) program, which targets Base24 classic customers and provides them with a bridging strategy to ACI's modern Universal Payments (UP) technology. RPS provides a smoother migration path and as a result has seen strong uptake across ACI's customers. The company says the overwhelming majority of Base24 classic customers are renewing under the RPS program, which on average has been increasing contract value by 25-35% over the five-year term.

ACI anticipates the cloud side of its business, where ACI's offerings are delivered on a SaaS and platform model via its four global datacenters, will see \$400m in revenue and negative \$40m in EBITDA in 2017. Cloud is a much newer delivery model for ACI, with customer traction – namely merchants – beginning roughly four years ago. ACI has made significant investments in cloud delivery in that timeframe, with advancements that include new European datacenters and enhanced cybersecurity capabilities, further augmented by acquisitions of companies including Retail Decisions (2014, \$205m) and PAY.ON (2015, \$200m). The company believes that it is nearing the end of its cloud investment cycle and will soon start to reap the benefits of a more favorable cost structure against the backdrop of its more than \$2bn backlog of cloud bookings. It also sees cloud delivery as a significant new logo opportunity and, in many ways, the future of its business.

In terms of specific platform enhancements, we like ACI's growing focus on APIs; i.e., its October launch of new API manager capabilities. These capabilities tie in nicely to regulatory forces such as GDPR and PSD2 and help to support the broader industry push toward open banking. ACI's API manager capabilities are available across its

on-premises and cloud-based UP portfolio of products. In line with the emphasis on APIs, the company says it is actively pursuing development techniques like micro-services, agile development and containerization across its business. ACI is also making significant investments in data and intelligence capabilities, most visibly through the recent launch of its UP Payments Risk Management offering, which brings together adaptive machine learning and analytics to deliver real-time fraud screening. Up Payments Risk Management has been introduced at a time when 451 Research finds that 60% of US merchants have noted an uptick in fraudulent activity in their digital channels compared with 2016.

Looking out over the five-year horizon, ACI is targeting the 'rule of 40%' for its cloud business, hoping to achieve annual revenue and EBITDA growth equal to 40%. As for the company as a whole during the period, it anticipates organic revenue of mid- to upper-single digits, new booking growth in the high single digits and adjusted EBITDA margin of 1% per year.

## STRATEGIC VISION AND BUSINESS DRIVERS

ACI believes its total addressable market between its four segments – financial institutions, merchants, billers and financial intermediaries – to be 1.1 trillion transactions in 2017, reaching 1.6 trillion by 2021. One of the key advantages of ACI's position is that collectively its customers often touch a single transaction multiple times as it moves across the value chain from initiation to completion. This means that not only could ACI profit multiple times from the same transaction, but it is also largely insulated from the impact of power and volume shifts between payments stakeholders.

Two of the more prominent business drivers that ACI was keen to discuss at its event were real-time payments and IoT. The company has long been an evangelist for real-time payments and has its hands in multiple initiatives around the globe, including The Clearing House in the US, Faster Payments in the UK and PromptPay in Thailand. ACI says it added seven new central infrastructure schemes in 2017, including PayNet in Malaysia and STET in France and Belgium. It benefits in these types of deployments not only by deploying the central infrastructure required to facilitate real-time transactions, but also by often supplying member banks with a cloud-based gateway that allows them to tie into the real-time infrastructure. 451 Research believes global demand for real-time payment systems will continue to increase, given that they stand to benefit businesses and consumers alike, with use cases ranging from insurance claim payouts and bill pay to P2P. Real-time payments bring much-needed efficiency to the financial system, helping to unlock working capital, improve cash flow and provide enhanced budgetary control.

IoT, while still undeniably nascent, is also of interest to ACI. IoT serves as an effective expansion of the payments acceptance network, making commerce more accessible and helping to squeeze cash out of the system. ACI believes IoT will directly benefit its business by driving not only demand for cloud-based payment platforms and real-time transactions, but pushing merchants toward direct-connect payment integrations.

## COMPETITION

ACI's retail-centric competition includes major merchant acquirers and third-party payments software providers. While ACI offers vendor-neutral technology, in most cases it competes with vendors that offer a complete payments service. More tenured rivals in this regard include First Data, WorldPay, Heartland Payment Systems and CyberSource, while newer entrants include Adyen and Square Inc. ACI also encounters Ingenico and Verifone, particularly due to their respective acquisitions of GlobalCollect and AJB Software Design. For business pertaining to retail and transaction banking, ACI competes with players that include FIS, Bottomline Technologies, Dovetail Systems, IBM and Fiserv.

## SWOT ANALYSIS

### STRENGTHS

ACI continues to invest heavily in its payments technology stack, augmenting it with deeper capabilities in areas like intelligence and fraud prevention. The company has developed best practices in real-time payments deployments globally that can be applied to the still-nascent US market.

### WEAKNESSES

While ACI sees its future in the cloud, it must continue to make investments in on-premises approaches that are still favored by a large part of its client base. Cloud business is still experiencing negative EBITDA (although the company anticipates this will soon change as it nears the completion of a significant investment cycle).

### OPPORTUNITIES

ACI is well positioned for emerging industry trends such as cloud and IoT. The company has growing opportunities with retailers that are looking to execute on unified commerce strategies.

### THREATS

The competitive landscape continues to diversify, with mounting pressure from new entrants and point players. Reluctance of financial institution clients to migrate to the cloud would thwart growth prospects.