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Visa, Inc. (V)

Q4 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

MANAGEMENT DISCU.S.SION SECTION

Operator: Welcome to the Visa, Inc.'s fiscal quarter four earnings conference call. All participants are in a listen only mode until the question and answer session of today's call. Today's conference is being recorded. If you have any objections, you may disconnect at this time. I would now like to turn the conference over to your host, Mr. Jack Carsky, Head of Global Investor Relations. Mr. Carsky, you may begin.

John R. Carsky
Head of Global Investor Relations

Thanks, [ph] Charles.

Good afternoon, everyone and welcome to Visa, Inc.'s fiscal fourth quarter and full year 2014 earnings conference call. With us today are Charlie Scharf, Visa's CEO and Byron Pollitt, Visa's Chief Financial Officer. This call is currently being webcast over the Internet, and can be accessed on the investor relations section of our website at www.investor.visa.com. A replay of the webcast will also be archived on our site for 30 days. A PowerPoint deck containing financial and statistical highlights of today's commentary was posted to our website prior to this call as well.

Let me also remind you that this presentation may include forward-looking statements. These statements are not guarantees of future performance and our actual results could materially differ as a result of a variety of factors. Additional information concerning those factors is available in our most recent reports on Forms 10-K and Q, which you can find on the SEC's website and the investor relations section of our website. For historical non-GAAP or pro forma related financial information disclosed in this call, related GAAP measures and other information required by Reg G of the SEC are available on the financial and statistical summary accompanying today's press release. This release can also be accessed through the IR section of our website. And with that, I will turn the call over to Brian.

Byron H. Pollitt
Chief Financial Officer

Turn it over to who?

John R. Carsky
Head of Global Investor Relations

I can't believe I just said that. Byron.

Byron H. Pollitt
Chief Financial Officer

Thanks, Jack.

Let me begin with my usual call outs and observations. First, as you can see from our earnings press release, we reported the quarter on an adjusted basis, based on the litigation accrual we took in the wake of the $450 million escrow deposit we made in late September. As a reminder, this litigation provision is covered by our retrospective responsibility plan. The $450 million additional litigation accrual has been estimated off of recently completed settlements with selected opt-out merchants, representing approximately 3% of the total opt-out merchants based on sales volume, as well as the status of negotiations and discussions with other opt-out merchants.

Excluding this litigation accrual, we reported adjusted diluted earnings per share of $2.18. In addition, consistent with past practice, the company's funding of the $450 million litigation escrow deposit had the same effect as a share repurchase, as it reduced the Class B share conversion ratio by an amount equivalent to buying back 2.1 million Class A equivalent shares at $215 per share. As a result, at the end of the fiscal year, we had 618 million shares of Class A common stock outstanding on an as-converted basis.

We continued to experience solid constant dollar payment volume growth in the low double digit range, both in the U.S. and internationally. U.S. credit continued to strongly perform, led in large part by Chase portfolio conversions. That said, looking ahead to fiscal 2015, our near term outlook remains cautious, given the modest pace of economic recovery, the geopolitical situation, Ebola, low currency volatility and continued FX headwinds from a very strong U.S. dollar.

Turning to revenue. As expected and previewed on our call last quarter, revenue growth for the fiscal fourth quarter rebounded, growing 10% year-over-year on a constant dollar basis or 9% nominally, which reflects about one and one half percentage points of FX headwind in the quarter. For the full fiscal year, revenue growth was 10% on a constant dollar basis and 8% nominally, recognizing close to 2 percentage points of FX headwind for the entire fiscal year.

A word on international transaction revenue. Revenue growth for the quarter was 4%, compared to 9% nominal growth in the cross border payment volume. The difference can be explained by the continuation of historically low currency volatility discussed last quarter. That said, we saw an uptick in volatility across a basket of currencies in September, which continued into October. While we remain cautious in projecting this metric, results in September and October are encouraging.

Client incentives for the fiscal fourth quarter came in at 19.2%, putting us right on target with our full year guidance of around 17%. As we telegraphed on last quarter's call, the elevated level of incentives was the result of key renewals in Canada and CEMEA [Central and Eastern Europe, Middle East and Africa], which completed in fiscal Q4. I will speak to fiscal 2015 in a moment.

Lastly, as always, we remain confident in our future growth prospects and fully committed to returning excess cash to our shareholders. To this end, in Q4, we committed $1.2 billion to reduce the number of Class A equivalent shares by 5.7 million, at an average price of $213. This was accomplished through open market purchases and as noted earlier, a deposit of $450 million in the company's litigation escrow account.

Further, our board approved in October a new $5 billion share repurchase authorization that, in combination with the $682 million remaining from the prior authorization, gives us $5.7 billion to deploy in the coming quarters. We also recently announced a 20% increase in our quarterly dividend from $0.40 to $0.48 per share. This level of increase is consistent with our previously stated objective of a 20% payout of the previous fiscal year's net income, or in this case, adjusted net income.

Now, let's turn to payment volume and transaction growth. Global payment volume growth for the September quarter in constant dollars was 11%, slightly down from the June quarter. The U.S. grew 10%, and international grew 13%. Drilling down further, for the September quarter, U.S. credit was 13%, slightly higher than the 12% in Q3, in part due to Chase conversion activity. Through October 21st, U.S. credit improved to 15% growth. U.S. debit was 7% in Q4, a 1 percentage point downshift compared to Q3. Through October 21st, U.S. debit is back up at 8% growth. Taken together, U.S. payment volume growth through October 21st was 11%, up 1 percentage point from the Q4 level.

Global, cross border volume delivered a 10% constant dollar growth rate in the September quarter, up nicely from 7% in the June quarter. The increase was attributable to stronger activity across a broader set of travel corridors with some effect from the timing of Ramadan. Notably, there was a nice pick up in travel to the EU from the Middle East, China, and Australia. The U.S. grew at 7%, and international grew at 11%. Through October 21st, cross border volume on a constant dollar basis held steady at 10% growth with U.S. growth at 6% and international registering 11% growth. Underperforming travel corridors include several countries in Latin America, along with Russia and Ukraine.

Transactions processed over Visa's network totaled $16.9 billion in the fiscal fourth quarter, a 9% increase over the prior year. The U.S. grew 8%, while international delivered 14% growth. Through October 21st, processed transaction growth improved to an 11% growth rate, up 2 percentage points. The U.S. grew 9%, while international grew 15%.

Now, turning to the income statement, net operating revenue in the quarter was $3.2 billion, a 9% increase year-over-year, driven primarily by growth in service and data processing globally, and as mentioned earlier, negatively impacted by about 1.5 percentage points of foreign currency headwind. For the full fiscal year, net operating revenue was 8% over the prior year, or growth of 10% on a constant currency basis.

Moving to the individual line items for the fiscal fourth quarter, service revenue was $1.5 billion, up 8% over the prior year and was driven by moderating global payment volume growth. Data processing revenue was $1.3 billion, up 14% over the prior year's quarter, based on solid growth rates in Visa processed transactions both in the U.S. and internationally. The delta between the quarter's 9% processed transaction growth and the 14% revenue growth was largely due to higher year-over-year growth in U.S. debit fees implemented in 2012. Of the delta, approximately one quarter was due to lapping a one-time refund of an overpayment in Q4 of the prior year. The balance is ongoing, as this fee structure stabilizes after having been implemented two years ago.

As highlighted earlier, international transaction revenue was up 4% to $938 million, versus 10% constant dollar cross border volume growth over the prior year period as a result of a broad range of currencies experiencing volatility well below the 10-year median in contrast to the year ago quarter when volatility was near record highs. We are hopeful for a return to a more normalized volatility pattern in the coming quarters.

Turning to other revenue, it showed a slight uptick in the quarter, reflecting a true up of the Visa Europe licensing fee, some of which was catch up. Initially the licensing fee was $142.5 million U.S. annually. The annual rate for fiscal year 2015 will be around $148 million. Excluding the litigation provision, total operating expenses for the quarter were $1.2 billion, flat from the prior year. For the full fiscal year, adjusted operating expenses were also flat to fiscal 2013.

Adjusted operating margin was 62% for the fourth quarter, and 64% for the full fiscal year, both in line with our guidance of low to mid-60s. Capital expenditures were $227 million in the quarter, and $553 million for the full fiscal year. The weighted average number of fully diluted shares outstanding for the quarter totaled 623 million, and 631 million for the full fiscal year.

Before I speak to specific items of guidance, let me provide some early perspective on how we see the timeline of fiscal full year 2015 playing out. We approach 2015 bullish on the long term, given the underlying strength in payment volumes and processed transactions, and cautious in the short term. Here's some of the underlying observations and assumptions informing our planning for next year.

First, while we expect U.S. and international payment volume growth to remain healthy, we have not yet seen acceleration in global economic growth. Cross border volumes are rebounding as we reported 10% growth in the quarter, but this is still below the low double digit levels we experienced at this point last year, and so we remain appropriately conservative in positioning this metric.

As perspective, we know that these growth rates can recover without notice, and that the notable declines in Latin American growth rates lap in January of 2015, and the market declines related to the Russian/Ukraine crisis will lap in March. Everything else equal, once these events anniversary, the pickup in cross border growth could be in the 2 to 3 percentage point range. As to currency volatility, as I said earlier, while we have seen a bounce in September and October, we are not sure how sustainable this is.

Turning to a different subject, we will be taking selected pricing actions commencing in April of 2015 on certain U.S. acquirer fees, which will result in higher revenue growth in the second half of our fiscal year. Given that we have not taken actions in this area in four years, we believe the length of time and the substantial value these cross border transactions bring to merchants make a modest adjustment appropriate.

In addition, based on recently completed, significant client renewals that Charlie will speak to in a moment, as well as the successful growth in client payment volumes for both issuers and merchants, we will see higher levels of client incentives as measured by percent of gross revenues with the highest percentage levels expected in the first half of the year.

In dollar terms, quarterly incentives in fiscal 2015 should be more indicative of the $700 million plus level seen in fiscal Q4. Finally, consistent with past practice, we expect to deploy our excess cash flow in 2015 to service our recently increased dividend and to continue to repurchase our shares.

To sum up, in terms of guidance for fiscal 2015, we are contemplating constant dollar revenue growth of low double digits with 2 percentage points of negative foreign currency impact. Absent any catalyst, we see our constant currency growth today at the very low end of the double digit range.

As previously stated, our guidance contemplates several pricing actions to be effective at the beginning of fiscal Q3. This means our year-over-year revenue growth rates are expected to be double digit in the second half and in the mid-single digit range in the first two quarters as we lap low levels of incentives in the prior year.

Turning to client incentives, as a percentage of gross revenues, we expect it to be in the range of 17.5% to 18.5%. Operating margin in the mid-60s. Full year tax rate in the low 30s. On tax, as a reminder, when viewed quarterly on a year-over-year basis, the tax rate in Q2 of fiscal year 2014 was significantly reduced due to a tax benefit recognized under IRS code Section 199 that included prior years along with an ongoing benefit.

Turning to earnings per share, on an adjusted basis, mid-teen growth, and annual free cash flow in excess of $6 billion.

Lastly, and before I hand the call over to Charlie, I wanted to address the topic of cross border growth. In my conversations with analysts and investors, there have been a number of questions raised regarding our cross border volume growth rates. In that light, on a one-time basis, we thought it would be useful to provide some incremental perspective, which we have included on page 3 of the appendix of our PowerPoint presentation.

During our earnings report out each quarter, Visa includes in its operational performance package its cross border volume growth rates on both a nominal and constant basis excluding Europe. The first two columns show what we have historically reported in the operational performance data pack. The third column is new and represents a global view of Visa, including Europe on a nominal basis to facilitate competitive comparisons across a common geographic footprint.

The next two columns also include Visa Europe and present cross border growth rates recognizing there are at least two different methods for calculating those growth rates, which can have very different outcomes.

When Visa historically measures and reports cross border growth in constant currency, it uses the year-over-year change in exchange rates for the country currency in which the merchant transaction took place. Those growth rates are presented in the fourth column labeled "Merchant Country." Alternatively, one could also calculate cross border growth rates using the currency representing the country in which the issuer resides. Those cross border growth rates are presented in the fifth column, labeled "Issuing Country."

Of course, other factors can also impact growth rates, such as relative portfolio exposure to different countries and their currencies, the method for selecting FX rates and translating back to the U.S. dollar and share shifts, but those are much harder to isolate and quantify.

Recognizing the complexity of this topic, in addition to the one-time slide, we have provided an illustrative example of a cross border transaction and the effect it can have on growth rates depending on the underlying methodology employed. You will be able to find it on our IR website located with the other earnings-related materials and that will be posted at the immediate conclusion of this call. We will then be available for follow-up conversations if you would like further explanation.

And with, that I'll turn the call over to Charlie.

Charles W. Scharf
Chief Executive Officer & Director

Thank you very much, Byron, and good afternoon, everyone.

First, I thought I'd start with just a couple of brief thoughts on our fiscal fourth quarter. As Byron went through, our performance came in pretty much as we would have expected, adjusted earnings per share growth this quarter of 17% and 19% for the full year. As we think about it, it's actually gratifying given the continued subdued economic environment globally, and the volatile geopolitical environment, which do affect our business. It says a great deal about the business itself and the company that we're lucky to be able to be a part of here.

Revenue growth continued to be constrained by the strong dollar, the low currency volatility compared with historical norms and cross border growth below historical levels. As Byron mentioned, we believe that these items that have constrained our revenue growth are cyclical and can change very quickly.

More importantly, we really spend most of our time looking at the underlying fundamentals of the business and they continue to perform very well. In constant dollars, our double digit payment volume growth with particular strength in the U.S., in addition to double digit cross border payment growth. Processed transaction growth was strong as well, and as Byron mentioned these trends improved slightly in October through the 21st. Beyond our data through the 21st, our ability to see the future is the same as yours, but we're cautious about the global growth as we plan for next year.

Just a couple of comments about capital now. We've been very consistent as a company in how we think about capital allocation. We continue to believe the highest and the best use of our excess capital is to reinvest it, both organically and through acquisitions to further our growth. After that, we believe in growing our dividend as our earnings grow and maintaining a payout ratio of about 20% of our trailing earnings. And we will opportunistically return the rest of our excess capital through share repurchases.

In 2014, we did all of these things, investing both organically in the business, outside investments. As Byron mentioned we effectively bought back $4.6 billion of our stock during the year. And as we look forward, we remain committed to continuing our practices. Last week, our board approved a 20% dividend increase from $0.40 to $0.48 a share per quarter and they also approved a new $5 billion share repurchase program in addition to the roughly $680 million remaining from the prior authorization.

Given the opportunities in the payment space, we will continue to look for and prioritize growth opportunities, but our board's actions should give you an indication of how we feel about our opportunities to grow in the future.

Let me talk for a second about Russia. Russia continues to move towards its goal of controlling domestic processing. Last Tuesday, President Putin signed modifications to the national payment system law which positions the Russian Central Bank owned national payment card system as the preferred domestic payment processor. The law delayed the implementation of the guaranteed deposit from the end of the October 2014 to March 31, 2015 to allow for an appropriate transition. And when the national payment card system is utilized, there's no guaranteed deposit requirement. We are working closely with the government and our clients to ensure a smooth transition.

We continue to expect to lose a portion of our domestic processing revenues in fiscal 2015, of about $50 million. This is likely to grow up to about $70 million on a full year basis when fully implemented. We continue to believe we'll play an important role in Russia. Once this transition occurs and our baseline is reset, we will continue to focus on helping our clients grow both domestically and internationally.

And with that, I will talk for a second about our client franchise, and just talk about some of our most significant markets, especially some of the things which do create lumpiness in our incentives as we look forward into 2015. First, let me start with Russia. We continue to work with our clients to support their businesses. We recently signed multi-year agreements with several Russian banks, including Sberbank, by far the largest issuing bank in Russia.

In the United States, we continue to have great success. We renewed a multi-year credit and debit agreement with Bank of America, our second largest client globally. To put this into perspective, if B-of-A were a country, it would be one of the largest in the world for Visa. Our agreement provides the opportunity to grow our share from our prior agreement, and we're thrilled with the relationship we have with Bank of America.

And remember, when we signed our ten-year agree with JP Morgan Chase, they agreed to move the majority of their non-Visa volume to Visa. These conversions have begun and are going extremely well. Per Nielsen, total expected volume to convert has been estimated at over $40 billion. It's a bit less than 10 million cards overall, and the conversions are expected to be completed by February 2015. In the U.S. credit market, we continue to gain share, and remember, this is the largest driver of our profit in the world.

Canada is one of our other large countries. Over the past two years, we have signed long-term contracts with issuers and partners representing over 85% of our business, including Scotia, CIBC, RBC, TD, and Aeroplan. Visa's Canadian issuers have invested heavily in new rewards programs for Canadian consumers, driving very strong growth and we benefit from these great partnerships that we have.

Brazil is a complicated market for us, given the elections and the recently implemented cross border taxes, but we continue to grow relationships there as well. We renewed a multi-year credit and debit and commercial agreement with Caixa, the fifth largest issuer and we renewed a multi-year career, credit, debit and prepaid agreement with Banco do Brasil, our largest issuer in Brazil and the Latin America region.

Just a second on co-brands, which seem to be getting a lot of press these days. First, just as a reminder, we think we have the best and we have the largest co-brand platform in the world, with 7 of the top 10 programs exclusively Visa, and great partners outside of the U.S. as well.

This quarter we renewed a multi-year credit agreement with the Gap. We will continue to be the payment brand and network for the Gap, Banana Republic and Old Navy co-brand cards and our partnership with Gap extends beyond the retail store environment. Websites for the Gap and its family brands are now offering Visa Checkout as an online payment service. In addition to the deals that we have announced today, we have agreed to terms to move a significant consumer credit co-brand from a competitor to Visa. We look forward to sharing more about this as cardholder plans take shape.

And we have talked a bunch about bringing new capabilities to market for merchants, and in addition to what we are doing in Visa Checkout, we are continuing to start to roll out products for the merchants. Last quarter, we forged a proprietary relationship with TrialPay and had a small team from TrialPay join Visa to lead the development of a new product platform designed to help our merchants acquire more customers and sales opportunities.

TrialPay is one of the leaders in presenting consumers relevant merchant offers during a transaction and we are using their technology and experience, together with all of the capabilities that exist at Visa, to build a platform that will drive millions of new customers to our merchant clients. You will be hearing more about this in the coming months.

We rolled out a new product called Visa Transaction Advisors in August. It's a new solution, which helps U.S. fuel retailers prevent credit and debit fraud at the pump. This service enables merchants to use real-time authorization risk scores to identify transactions that can involve lost, stolen or counterfeit cards. More than 65 million transactions per month are being reviewed by the service at 25,000 locations across the U.S. Some merchants have seen a 23% reduction in fraud at participating locations. Merchants using the service include top U.S. brands such as Shell and Chevron. These are just the beginning of our focus on directing our capabilities towards merchants.

To say a few words about payment security and U.S. chip cards. At this point, most people understand most of the benefits that we get from moving from mag stripe towards chip-enabled cards, but there are also some important unappreciated benefits, just one I want to highlight. The approval rates, again, this is in the U.S., of chip cards versus mag stripe are 97.9% for chip cards versus 92% for mag stripe on cross border and 99.2% for chip cards versus 98.4% in domestic transactions. Today only 3.6 million terminals at 55,000 locations accept chip cards, 19.8 million Visa cards are in circulation, up from 56% – up 56% from 12.7 million but still a very small number relative to the total cards that are outstanding.

Having said that, we see most people have read issuers, acquirers and merchants are working diligently to increase these numbers. The payment security task force that we participate on, with a series of other people in the industry put out a press release that said acquirers representing 80% of U.S. purchase volume estimate that at least 40% of U.S. merchant terminals will be chip-enabled by the end of 2015. The group also reported that nine of the country's largest payment issuers estimated that they would issue more than 575 million chip-enabled cards by the end of 2015. There are also estimates that over 90% of cards will be chip-enabled by the end of 2017.

Turn for a second to just talk about our digital efforts, which are a huge focus for us inside the company. This quarter, you started to see some tangible progress as we have begun to introduce new digital solutions into the marketplace. First, a reminder that online purchase transactions for us are 19% of our business today, and also that in the U.S., online, tablet, and mobile purchases are growing at high double digit to triple digit rates versus a face-to-face rate of single digits. We are aggressively pursuing this market with the expectation of growing our share. You have seen several things to support this: Visa Checkout, Visa Token Services, Visa Digital Services and Apple Pay.

First let me talk about Visa Checkout. Remember, this is our solution, which enables you to pay online in a very simple, secure way with a username and password. It's easy and secure for consumers, and it's a terrific solution for merchants. It's easy to integrate and it's been proven that it increases the checkout flow rate for merchants.

We continue to make great progress. We passed 1.9 million registered users. Over 200 financial institutions are partnering with us to roll this out to their clients and merchant reaction has been terrific. Merchants live today include: Neiman Marcus, Pizza Hut, Staples, 1-800-Flowers, TicketMaster, Live Nation, Lululemon, Petco, and Pop Sugar. Other new merchants who were live include the Gap and its brands, Tory Burch, Gymboree, Crutchfield, and Orbitz. And more who have signed but have not yet gone live include United, Virgin America, and American Apparel. Hopefully many of you have seen the advertising, both in traditional media, as well as digital and social, with great partners such as Pizza Hut and Neiman Marcus, Newegg, and Staples. We intend to win and love the fact that we're partnering with merchants to drive Visa Checkout as a preferred solution in online commerce.

To increase our reach and scale, we also integrated two partners, 3dCart and ProPay, that provide access to a combined total of over 100,000 merchants. In addition our merchant acquired partners such as First Data and TSYS are integrating Visa Checkout for both their core platform and subsidiaries.

As we evaluate our progress, we're focused on addressable online volume, not the number of merchants, and are very happy with our progress. To date, over $33 billion in live addressable volume accepts Visa Checkout. Another $30 billion has been signed, and we're very confident that these numbers will be much larger as we get to the end of 2015.

In early September we announced the launch of Visa Token Services. We talked about this a bunch, so I won't dwell on it. But it enables all Visa clients to offer their cardholders a secure and easy way to pay for mobile and online transactions, as well as it enables new forms of payment, which are more secure than exist today. Apple Pay is the first use case in the market, but many more will follow.

More broadly, we're excited about Apple Pay, but for us as we think about what's going to be coming into the marketplace, it's only the beginning. We expect a proliferation of exciting mobile and digital solutions, leveraging our new capabilities.

In October, we launched our sandbox development and testing environment, for Visa Digital Services, as well as updated our SDKs that will enable issuers to begin embedding new forms of contactless payments in their Android applications. Eventually, merchants and approved third parties will be able to harness the safety and security of Visa payments to create new proximity payment experiences for their users. These services will be commercially available in the U.S. in January of 2015. Clients have already begin integrating to our development environment, and are building and testing their applications in advance of our full commercial launch in 2015.

And as far as Apple Pay goes, just a couple of quick comments. We're excited about our participation. We believe it's good for consumers, it's good for merchants, and it's good for our industry. Our focus has been on security, scalability and inclusiveness. To the last point, we're working with over 1,000 financial institutions today, and hope to see all of our issuers participate. On Monday, Tim Cook announced that over 1 million cards had been loaded to iPhone 6s in the first 72 hours, Visa represented over 600,000 of those requests. Early days but very encouraging.

And then just a note about for us to be able to deliver all of these differentiated services in the marketplace, we continue to build our engineering and technology capabilities. To that end we announced that we plan to add 1,000 technologists and engineers in the U.S. This is in addition to the thousand that we will be hiring into a new facility in India, which will open in 2015.

And just to wrap it up, before we open it up for questions, let me just say a couple of other things here. There's been much talk about disruption in payments and what it means for us. Most of the disruptors are great enablers for consumers, merchants and our industry. Apple is the first great example. We and our clients can be great enablers of great consumer and merchant experiences. We bring thousands of banks, millions of customers and the convenience, security, customer service, rewards and other great features that consumers like. You will see many other enablers evolve that we will partner with and we are doing this all in support of our existing clients.

And as we look to the future, we continue to see great growth opportunities for payments. We have our traditional channels and traditional ways of doing business, but we sit here today, and we see the mobile opportunities in both the developing, the less-developed and the developed worlds as being great drivers of our mission. P-to-P, commercial and our merchant relationships; all things that we are going to focus on to continue to build our business.

And with that, operator, I think Byron and I are ready for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator instructions] Our first question comes from Jim Schneider from Goldman Sachs. Your line is now open.

Jim E. Schneider
Goldman Sachs & Co.
Q

Good afternoon and thanks for taking my question. With regard to client incentives, you talked about those being first half weighted in fiscal 2015. Can you talk about how many of your top ten issuing clients are renewing this year, and do you expect all of those renewals to happen in the first half of the year, given the front loading that you talked about earlier?

Byron H. Pollitt
Chief Financial Officer
A

Byron here. So of the top 10, I would say one is scheduled to renew this year. And the front end loading is really a function of two things, and it's not what you just described. It's really a function of the deals that we most recently completed. We had a heavy deal flow that came to completion in Q4, and then will begin working their way through the fiscal year 2015, but also, as we have commented on many times before, incentives can be very lumpy in the way that they unfold. And so in the way that the deals were executed and we expect a front end loading of incentives with regards to the P&L, and then the guidance that we have given on a full year basis fully contemplates the lumpiness, so to speak, and we expect to deliver full year incentives somewhere in the 17.5% to 18.5% range.

Jim E. Schneider
Goldman Sachs & Co.
Q

Thank you.

Charles W. Scharf
Chief Executive Officer & Director
A

The only thing, this is Charlie, that I would just add is that also keep in mind that client contracts sometimes renew off cycle. And, you know, that's contemplated in our guidance as well.

John R. Carsky
Head of Global Investor Relations
A

Next question.

Operator: Our next question comes from Craig Maurer from Autonomous. Your line is now open.

Craig Jared Maurer
Autonomous Research US LP
Q

Yeah, hi. Thanks. Two questions. First, if could you comment on the apparent announcement out of the Chinese government this morning that they are going to move to open up that market for additional settlement clearing networks for bank cards.

Secondly, a technical question on Apple Pay. You know, we have noticed that American Express is able to provide real-time transaction alerts, whether these are Apple Pay transactions or any other swipe. You are always getting an alert. On Chase transactions, which you have provided a bespoke version of Visa, they don't seem able to provide this service. Are they – I mean, it would seem that Chase is not fulfilling the promise of that transaction that you had entered into with them or am I missing something? Thanks.

Charles W. Scharf
Chief Executive Officer & Director

A

Okay, let me do the second part first. So first of all, just to be clear, when you complete an Apple Pay transaction, there is immediate notification on the device itself that shows you that the transaction has taken place, the dollar amount, and who the merchant is. You can then effectively flip the card over and see the running tally of all of your transactions. So there's no, at least from our experience and my personal experience, there's no lack of clarity whether or not you've completed transactions and it is very real-time.

The question about whether people are then providing additional alerts on top of that, first off, that you've got to talk to your individual bank about. We offer a service, which we provide to a series of banks out there, that do allow for real-time alerts. I can tell you I personally signed up for it, and I get it on as real-time a basis as you can expect. But different banks choose what they want their consumer experiences to be. But having said that, again, it exists in real-time on the Apple device.

As far as China goes, there's really not a lot more to talk about than what you've read, which for those who haven't read it, there was an announcement today that the Chinese government will open up the market to competition in our business. We don't know anything specific other than that. We obviously welcome it. And we look forward to seeing the specific details and working with the people within China to figure out what we need to do to participate in that marketplace where we believe we can add a lot of value.

John R. Carsky
Head of Global Investor Relations

A

Next question.

Operator: The next question comes from Darrin Peller from Barclays. Your line is now open.

Darrin D. Peller
Barclays Capital, Inc.

Q

Thanks guys. Look, following a year where revenue growth ended up being a little more challenging than expected given some of the cross border trends being slower, it's obviously nice to see the end of the year pick up in those trends. But just, I guess following up on the guidance, if you can help us understand the assumptions you're making around a couple of different attributes including volume growth versus the way it's trending in October, as well as what part of this is from pricing? Just because we're getting a lot of questions on how much pricing can actually impact the overall top line guidance of low double digits. Thanks, guys.

Byron H. Pollitt
Chief Financial Officer

A

So the headwinds that we had this past year, I mean, many of them still continue into this year. Currency volatility we guided – we didn't actually expect to guide to two full percentage points of FX headwind a second year running. But particularly the strengthening of the U.S. dollar over the past two months has now made that much more likely. We were thrilled to see cross border beginning to bounce back, but that is not – it's too early to call that a trend. With regards to volume, it's based on low single digit constant dollar growth in volume gains, low double digit.

Charles W. Scharf
Chief Executive Officer & Director

A

Double digit.

Byron H. Pollitt
Chief Financial Officer

A

Double digit. And with regards to pricing, we don't go in – it's not our practice to go into the details of pricing but we have guided that it will take place in Q3, beginning of Q3. So this is very much second half weighted. And we also indicated in our guidance that we would expect to, with that pricing boost, be in double digit revenue growth in the second half of the fiscal year.

Charles W. Scharf
Chief Executive Officer & Director

A

Let me just pick up on that. As you've heard from both of us, we know what we know. We don't know what we don't know. But we look at what's going on in the world. And as we plan the company for next year, we have a cautious point of view of that. And so our cautious point of view suggests that we don't plan for very big increases in things driven by what's going on in the outside world, albeit we know that they will improve at some point. We don't know when, but we think it's prudent to plan otherwise.

John R. Carsky
Head of Global Investor Relations

A

Next question, please.

Operator: Our next question comes from Dan Perlin from RBC capital. Your line is now open.

Daniel R. Perlin
RBC Capital Markets LLC

Q

Thanks, good afternoon. I wanted to follow back up, Charlie, on your 19% online – I guess it's volume or revenue – I need to get clarification of that. But the question really is, that sounds like that piece of business is growing somewhere around three times faster than what you refer to as the face-to-face business. And I'm just wondering if you could give some sort of characteristics around how should we be thinking about revenue yields or all the products you are going to be able to put around that type of volume? It sounds like there's more pricing opportunities in the future with those types of transactions than maybe what we've seen on a legacy basis.

And then just for level-setting, Byron, is it 907 plus the mid-teens that's the guided number or are we adjusting for the second quarter last year benefit? Thanks.

Charles W. Scharf
Chief Executive Officer & Director

A

So on the first piece, so, the reason – what I referenced in my remarks was really to talk about two different things. Number one is we have a big business in the online world today, and the way we think about it is we have been remarkably successful in a world where we haven't had great products to compete.

We also stand back and we look at the growth and the growth rates of transactions done online, on tablets and on mobile are multiples of what's done face-to-face. So we both have a defensive reason to do it, but more importantly an offensive reason to help that migration and to participate in it. So the things that we are doing from Visa Checkout to Apple Pay to the things that are going to be using our Token Services and our Digital Solutions are all about having the best products in the marketplace to capture where the growth is, which is in the digital channels.

Relative to what it means for us from a pricing perspective, again, we have been very, very consistent on this, which is, we're not sitting here today thinking about this as an opportunity to capture more price. We are looking at this as an opportunity, one, to both be where the natural growth is, but, two, to help migrate all of those cash transactions, whether they're big value transactions or small value transactions, into the electronics space where we will hopefully capture more than our fair share.

We do have a pricing schedule for things – for our tokenization services. We said we are waiving those fees for a year, and we are going to see how this all plays itself out. But, again, we look at this as this is the future of commerce. We want to be there. We see that there will be more volume in that world than there is for us sitting in the world that we are today, and if we make this up on volume as opposed to price, that's just fine with us. If there are pricing opportunities in the future, we won't look the other way, but that's not our reason to do this.

Byron H. Pollitt
Chief Financial Officer

A

And to your second question, Dan, the short answer is 907. And the perspective is you were with us at the very beginning when we did our IPO. From the very beginning, part of our investment thesis was that we would manage down the tax rate every single year to the best that we could. We started out at 41%. We said we would manage it down to below 34%, 35% over about five years. We didn't stop at 5. We have continued to manage our tax rate. We have never adjusted or provided any EPS guidance that adjusted for a full year tax rate because that's just one of the levers we have to manage the business and we will continue to do so. So it's mid-teens off of 907.

Daniel R. Perlin
RBC Capital Markets LLC

Q

Excellent, thank you.

John R. Carsky
Head of Global Investor Relations

A

Next question, please.

Operator: The next question comes from Don Fandetti from Citigroup. Your line is now open.

Donald Fandetti
Citigroup Global Markets Inc. (Broker)

Q

Yes, Charlie, I was curious, your thoughts on the U.S. market. I mean, we are seeing some of your large bank issuers put up some loan growth, consumer confidence has picked up, but we are not really seeing it in the spend. I was just curious on your outlook and just wanted to confirm that there's no real improvement baked into guidance in the U.S.

Charles W. Scharf
Chief Executive Officer & Director

A

Well, again, I think, I mean Byron walked through some of the recent trends. Our performance in the U.S. credit market is strong. But we don't look at it as – or let me say differently. It certainly, in a really good performing economy, should look much better than it looks today. And we have not factored that into our thinking for next year.

Donald Fandetti
Citigroup Global Markets Inc. (Broker)
Q

Okay. Thanks.

John R. Carsky
Head of Global Investor Relations
A

Next question, please.

Operator: The next question comes from Sanjay Sakhrani from KBW. Your line is now open.

Sanjay Harkishin Sakhrani
Keefe, Bruyette & Woods, Inc.
Q

Thank you. I've got a question on client incentives. Understanding that you guys had a big renewal in 2015, but how should we think about its trajectory, looking ahead to 2016 and 2017? Are there any other large renewals coming up?

And then just one clarification on the assumptions embedded in the guidance. Currency volatility as it stands right now, is that a tailwind in 2015 and are you assuming no tailwind? Thank you.

Byron H. Pollitt
Chief Financial Officer
A

With regards to client incentives, from the beginning, in fact, going all the way back to the IPO, we have always viewed client incentives on an upward trajectory, recognizing that the typical client contract is five years, and that when a client contract comes up for renewal, and if they have been successful, as most are, nearly all are, in growing their portfolios, then the level of incentive adjusts to a higher level, recognizing the growth over the previous five years or whatever the term was. And that's the way the business has worked forever.

In addition, client incentives back at the IPO, were much more a developed market phenomena. And as the rest of the international group of countries have grown, we have applied client incentives more regularly to those multi-year contracts and so there's a natural and healthy and expected upward trajectory in client incentives. And so that's what you're seeing, and it's, to the extent that we have one big renewal next year, or this fiscal year, that's not driving it. What is driving it is what I have just described.

Charles W. Scharf
Chief Executive Officer & Director
A

It drives the lumpiness, but not that trajectory.

Byron H. Pollitt
Chief Financial Officer
A

That's very fair. It drives the lumpiness, but not the upward trajectory. And then, I'm sorry, your second question was?

Sanjay Harkishin Sakhrani
Keefe, Bruyette & Woods, Inc.

Q

The currency volatility.

Byron H. Pollitt
Chief Financial Officer

A

Yes, so on currency volatility.

Sanjay Harkishin Sakhrani
Keefe, Bruyette & Woods, Inc.

Q

Is that a tailwind for 2015 as it stands right now?

Byron H. Pollitt
Chief Financial Officer

A

Yeah, this one. Boy, this one's tough. No one saw last year coming. It was at historically low levels. We are quite sobered about how to think about that. And it would be very consistent for us to say that we have approached currency volatility with a high degree of caution. And as Charlie said earlier, we absolutely know what we don't know about how currency volatility will behave in the future. So as I said before, we were very pleased to see the September and October bounce. We didn't see it coming, but we're pleased to see it happened. But we remain very cautious in our guidance with regards to the role of volatility in the coming year.

John R. Carsky
Head of Global Investor Relations

A

Next question, please.

Operator: The next question comes from Chris Brendler from Stifel. Your line is now open.

Christopher C. Brendler
Stifel, Nicolaus & Co., Inc.

Q

All right, thanks. Good evening. I wanted to get a little more color, if I could, Charlie on the pricing you mentioned in April. I think Byron also said something about cross border. Is this a similar pricing action to what one of your major competitors did on inbound cross border? And if it is, does it change your thinking at all on how you wanted to view pricing? And I think we talked about in the past that this is a situation where you kind of are drawing a line in the sand and saying, we are going to be independent in our pricing decisions and price for value. Just give me a more color on that.

And then a follow-up, if I could, on UnionPay. It seemed like the articles are focused more on clearing rather than, say, the entire food chain in the payments business of authorization and settlement. Can you give us a rough idea of how much clearing is of total Visa revenues? Thanks.

Charles W. Scharf
Chief Executive Officer & Director

A

Why don't we start with the second one.

Byron H. Pollitt
Chief Financial Officer

A

The UnionPay and clearing?

Charles W. Scharf
Chief Executive Officer & Director

A

Yeah.

Byron H. Pollitt
Chief Financial Officer

A

Go ahead.

Charles W. Scharf
Chief Executive Officer & Director

A

I don't have the answer. I don't know, I'm not sure. Again, so the way we charge for our services are, we charge service fees and data processing. And if we process the transaction, then we reap data processing fees and that number's on our income statement and service fees if our brand is on the card. We can't sit here today and know what China is contemplating when they talk about opening up the marketplace, quite frankly. We really have to wait and see what they say, and then understand what it means for us. Beyond that, we really don't know any more than you know at this time.

And then the second, pricing, why don't you start on pricing?

Byron H. Pollitt
Chief Financial Officer

A

So on pricing, I can say absolutely this was an independent decision. And as I said in my remarks, it has been four years since we have done something in this arena. Meanwhile we have continued to invest in the transaction environment related to cross border, and in our domestic markets. And at some point, we – you cross a line and you say the value created for both our issuers and our merchants warrant a modest change in pricing, which is what we have taken.

Charles W. Scharf
Chief Executive Officer & Director

A

And we have said very consistently, and I said it consistently and Byron said it consistently, there's no line in the sand any which way that the decisions are going to stand on their own and we have to look people in the eye and explain why they make sense for us in the environment that we live in, and we have looked at this one for a long time and feel it's the right thing to do.

Christopher C. Brendler
Stifel, Nicolaus & Co., Inc.

Q

Great. Thanks so much for the color.

John R. Carsky
Head of Global Investor Relations

A

Next question please.

Operator: Our next question is from Jason Kupferberg from Jefferies & Company. Your line is now open.

Jason A. Kupferberg
Jefferies LLC

Q

Thanks, guys. From what you see in your data, are lower gas prices in the U.S. sparking consumers to spend more actively in other verticals or are the lower gas prices just a drag on volume without any real offset? Because I guess we might have thought that the U.S. volume growth in the September quarter may have accelerated versus June, just given the Chase conversion, but it looks like it was pretty steady, so I am just wondering if there was a dampening effect from lower gas prices or what you guys are seeing there.

Byron H. Pollitt
Chief Financial Officer

A

So this is a story that is undoubtedly going to unfold a bit. There is no question that there is a modest drag that we see in the numbers with the drop in gas prices. It's less than 100 basis points, but it's clear there is a drag. You saw debit growth, which carries a lot of the gasoline transactions; you saw debit growth drop to 7% in the September quarter. You saw it bounce back to 8% through the first 21 days of October. But the data is still a little unclear whether that is spend that's being redistributed or in the prior year, if you may recall from October 1st through October 16th, the government went into a partial shutdown, and arguably depressed some spending during that period. And so this particular comp period is not clean.

But the thesis that we punch way above our weight when it comes to gasoline prices, well, use of cards at the pump works on the upside. It also can be a drag on the downside. And so then the big question is, how is that money redistributed as it frees up, and at this point, too early to call.

John R. Carsky
Head of Global Investor Relations

A

Next question, please.

Operator: Our next question comes from Bryan Keane from Deutsche Bank. Your line is now open.

Bryan C. Keane
Deutsche Bank Securities, Inc.

Q

Yeah, hi, it's Bryan from Deutsche Bank. Just looking at the data processing revenues growth at 14%, and I think volume at 9%, one of the things you talked about, Byron was the higher U.S. debit fees, some pricing that kicked in. I just want to make sure I understand what that was. It sounded like there was a pricing kick that finally is having an impact in 2012 with three-quarters of it still going to have an impact. I just want to make sure that I understand what that is. And then, finally, on the pricing in April of 2015 you guys expect, can you quantify that impact and where it will show up in the P&L? Thanks so much.

Byron H. Pollitt
Chief Financial Officer

A

With regards to the data processing fees, to be absolutely clear, there were no pricing actions in this area. This is about the pricing structure that we implemented back in 2012, and it was a – as you recall, it was a very different pricing structure than the one that we had previous to that point, and whenever you do that, it's going to take a couple of years to stabilize as you work your way through the full and complete implementation of that structure. That's what it is. It involves no price increase or no pricing action, and what I referred to earlier in my script has nothing to do with what you are seeing. And further, this kind of stabilizing should have a positive effect in the next couple of quarters, but diminishing, and by the end of the fiscal year should be, in our view, pretty much stabilized.

With regards to the other, since we are not yet public on the details of the pricing, we will wait for another day to consider addressing that.

John R. Carsky
Head of Global Investor Relations

A

Next question, please.

Operator: Okay. The next question comes from David Togut from Evercore Partners. Your line is now open.

David M. Togut
Evercore Partners (Securities)

Q

Thanks for taking my question. Could you address your pricing strategy more broadly over the next two to three years, perhaps gauge your pricing power and to what extent you intend to use it?

Charles W. Scharf
Chief Executive Officer & Director

A

Sure. I mean, there's – I mean, I would say there's nothing new in our thinking, which is, first of all when we think about our ability to grow the company for the long term, given what the options are – with what the opportunities are for us to grow volume, using pricing to get to numbers that we hope to be able to show over a period of time is not something that we rely on.

Having said that, we do think we should be paid fairly for what we do. And to the extent that we look at the services that we provide and feel that there's growing value in what we do, that's an opportunity for us to consider raising price. We know that people have options and so there's, you know, there has to be reasons to be able to do it. Whether it's on the issuing side or on the merchant side, and as I said, as I talked about before, we are spending a lot of time working with the merchant community on providing value for them, and as we do that, some of those things will result in things that will help us from a pricing standpoint, other things support our existing price.

So everything we do will be dealt on an individual basis. There's no line in the sand in any way we look at it, but again, as we come into the year and we think about what the opportunities are, pricing is something that we think is tactical for us and not particularly strategic at this point.

John R. Carsky
Head of Global Investor Relations

A

And we have time for one last question.

Operator: Okay. And our final question comes from David Hochstim from Buckingham Research. Your line is now open, sir.

David S. Hochstim
The Buckingham Research Group, Inc.

Q

Thank you. I wonder if you could give us an update on what is happening with CyberSource? It's still a pretty good growth in transactions but the growth rate continues to slow. Do you have competition?

Byron H. Pollitt
Chief Financial Officer

A

I would happy to. Well, I would be happy to give you an update. We are not happy with the update. As you've noted, the transaction growth has been slowing. And, as we've said on an earlier occasion, we missed an investment cycle. We are now investing significantly to catch up, both in our capabilities and our staff.

You should expect the anemic growth, so to speak, to continue for at least another couple of quarters. We expect that that will begin to turn around by the end of this fiscal year, and then just one call out.

The measure we give you is transaction growth. The transaction growth that we have lost has been among the least revenue generating of our transactions. So the revenue growth side of the equation has held up much better than the deterioration in transaction.

But that said, we're not happy with the results. But we have a very important role for CyberSource to play in our strategies going forward, and we are investing aggressively to bring that back to a much stronger growth rate.

John R. Carsky
Head of Global Investor Relations

And with that, we want to thank everybody for joining us today. And if anybody has follow-up questions, feel free to give Victoria or myself a call. Thank you.

Operator: And that concludes today's conference. Thank you all for participating. You may disconnect at this time. Thank you.