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Visa, Inc. (V)

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MANAGEMENT DISCUSSION SECTION

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

All right. Good afternoon, everyone. My name is Dave Koning. I'm a Senior Research Analyst at Baird covering payments and BPO and very pleased to introduce Visa and Mike Milotich, the Head IR. And I think Visa's name goes for itself. You probably all have one in your wallet. You know exactly what they do. They grow fast. The stock has been incredible.

And I want to tell one just quick story. So, a few years ago – a couple years ago now, their Head of IR was Jack Carsky and he was kind of legendary and I thought to myself how can anybody fill his shoes? He was so good. We even wrote a poem towards the night before earnings when Visa crushed in one quarter, but Mike has done an incredible job, very well-known now and totally filled the shoes.

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QUESTION AND ANSWER SECTION

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

So, with that, maybe we can start out with – I'll just ask you a question about the Western Union deal this morning, maybe you can talk just a little bit about that?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Yeah. So, the way we – we talked a lot about before with our Visa Direct business that we see international remittance as a component of the P2P use case that we think is very powerful and we can add a lot of value. So, the Western Union partnership is sort of another partnership. We've done similar deals with people like MoneyGram, EMQ and Remitly are some of the other players that we partnered with. And what we think we can really help them with is, one, making it a little bit more seamless and customer-friendly in terms of they can now offer to send their customer – their customers can send money to a Visa credential, so it gives them access to our 3.4 billion cards around the world, over 2 billion of those cards are debit cards, so – as a potential receipt of the funds. And in many cases, they already used those cards on the sending side of the equation.

And then, together with Earthport, which I'm sure we're going to talk about, we can offer them extended reach potentially into new markets as well as potentially simplify how they get to existing markets, because the correspondent banking model today can take multiple hops for you to get money from one country to another and with our capabilities, we can get there more directly. So, we think there's lots of things.

And then, I guess the last thing I would say is when they're using our capabilities, they get a lot of our compliance capabilities in terms of AML, KYC, sanction screening, a lot of our risk and fraud detection tools. All those things would come with leveraging our network. So, we think we have lot of ways that can enhance their business and drive incremental volume for us.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

Great. Well – and congrats on that deal.

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Thank you.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

And maybe if we take a step back and kind of go high level when we think what's the growth model over time? Is it retail of 5% globally and then what gets you kind of to that double-digit growth that you've been putting out? What's the kind of the formula?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

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Yeah. So, the formula is that we look at PCE growth in real dollars. So, because inflation – because so much of our pricing is in basis points, the real growth is important and that can grow, as you said, 4%, 5%, 6%. Then, you have the cash penetration. So, the displacement of cash, which, over time, if you look at the last several years, we've been able to grow at about twice the rate of PCE. So, it is – typically adds maybe 5 percentage points or 6 percentage points to our volume growth.

And then, the third component you should look at is in what's happening with net pricing. So, those first two components drive the volume and then, if you want to look at what the impact of the P&L is, then what's happening with our net pricing and generally what you see is that's a relatively small component, but if you look at our overall net yield, it tends to creep up a little bit. It reset in 2016 with the inclusion of Europe, which has lower yields, but generally speaking, our yield creeps up a little bit. So, that adds a little bit to growth.

And then, over the last couple of years then, we've added a fourth – so, those were the three components of our traditional business. And now, the last couple years, we've added a fourth, which is a new payment flows, which are outside of the PCE volume, so things like P2P and B2B and B2C disbursements. Each of those, in their own right, has trillions and trillions of potential volume for us. And so, that's how we think we're going to fuel growth into the future.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Got you. And the yield comment is interesting, because it's not just pricing, it's the mix of business too. What types of – parts of the business are growing faster? Is it cross-border? Is it certain parts of the world that are helping to improve the yield over time?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Yeah. I'd say a few things improve the yield. One is that we continue to win processing. So – and you can see it in the numbers we report. We report our process transactions where we clear and settle the transactions, we report our total. So, you can see sort of how much of the processing we capture and that's the same transaction, the same volume, it's just now we yield on it, because we're offering pricing – offering processing.

And then also, once we capture the processing that then tends to open the door to lots of other value-added services in terms of risk capabilities, loyalty capabilities, analytics to help our clients run their business more effectively. And if they're more successful, we're more successful. So, our interests are aligned so that they can start – they start paying us for some of these additional capabilities. And I would say as the pace of change and innovation has really accelerated, we're seeing more demand for that. It's just – even fairly large institutions just – the pace of investment that's required, they either necessarily want to focus on other areas or just don't think they can invest with that rate and therefore they are more willing to get services from us.

Some of it can be mixed in terms of where in the world we're growing faster, where the yields might be slightly better, but I would say it more has to do with our ability to add additional value and be selling additional services on top of just the core offering.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

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Okay. Great. And what about – maybe we can talk about – late last year, people started worrying a little about recession. Maybe what's the recession scenario for you? Last time, you still grew quite well, where are we at today? What might that look like for you?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.
A

Yeah. I mean, I guess what we – we think a few things that could be different, I guess, if and when it were to happen compared to 2008, 2009. One is that, generally, our business starts out with the more high-value discretionary type purchases. And as we further penetrate into a market, into a consumer's wallet, we get more and more of their everyday spending.

So, as I was mentioning earlier, we've grown at about twice the rate of PCE over the last several years, many years. And so, what that means is we're penetrating further and further into everyday spending, which is then not going to be as impacted if people start slowing their spending, these are things they have to buy anyway. They're just using it with – they're doing it with a Visa card now as opposed to maybe cash previously. So, that's one element.

The second is we do have a very large debit business that is also where most of that discretionary spend happens. The second thing is that within cross-border, if you were to go back 10 years ago, the cross-border business was almost entirely travel-driven and travel is very cyclical, very – can be very much impacted by the economic trends. And now, a meaningful portion of the cross-border business is e-commerce. And that e-commerce volume, in many cases, looks a lot more like everyday spending. It's just everyday spending that you get to do from your living room and buy something from anywhere in the world, right. And that's something that is new compared to 10 years ago that was very small in scale.

And then, the last thing I would say that could be different are these new payment flows that there are new sources of volume and growth for the business that we just did not have in during the last recession. So, hopefully, there isn't one coming any time soon, but we do think that the business can hold up well even if things start to slow a little bit macroeconomically.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.
Q

Over time, there's been fears of new technologies coming that could displace you and what's actually been interesting is things like Venmo or Apple Pay have actually helped to proliferate, not the opposite. What could be risk or how do you see the risk of new networks relative to Visa?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.
A

Yeah. I think the way we look at it is the first thing is we have to be very open minded about partnerships and who we consider a partner. So, we're not going to abandon the four-party model, but sort of the way – sort of how you define the four-party model is evolving and there are a lot of new players coming and we just have to be open minded in terms of who we're willing to work with. And I think our first instinct is to say everyone is a partner until it's very clear that they're not. So, that's the first – the way we look at it.

And then, from there, we say, okay, how can we – as long as we continue to innovate and we're flexible, we – it's easy to work with us, it's easy to access our capabilities as we've exposed things through APIs and we do it for something that's economical, then we're just going to make it very difficult for people to think it's in their interest to

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try to sort of go their own way and not leverage us, because we can bring so much value to the business in terms of our scale, our capabilities. Lot of things in payments are quite hard, which is why oftentimes, you find some businesses will initially start by sort of trying to go it alone. And as we often say, we're fairly good at co-opting those players over time, because they start to realize just how hard the sort of the guts of payments are and how much time and attention they spend on that instead of just trying to grow their business.

And so, that's where we can come and really help them scale on a fairly big level and add a lot of value in terms of the capabilities. They don't have to rebuild. They can just utilize what we have and because of our size, we can do it for an attractive price. And so, that's really how we look to continue to stay as the preferred partner for all payments whether – however you want to pay or be paid.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

And it often seems like the fear is that you lose share, but the reality is, in a lot of places, you gain share away from different networks and things over time. Do you have any examples of certain places around the world where there's been a different type of network or system that Visa has gone in and kind of started to take share because the banks realized it's a better way?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Well, I would say, I mean, there are lots of examples of that. I mean if you look at the U.S. P2P market, would be a great example where five years ago, none of that was on our rail. Now, we partner Apple Cash, Square Cash, Facebook, parts of enrolling PayPal, Zelle, all those players are utilizing our rails to do P2P, which just wasn't the case a few years ago.

I think there – you mentioned people like Apple and Google Pay, Samsung Pay, all using network tokens. You have a lot of the FinTech disrupters who are becoming partners and now even Paytm becoming an issuer and an acquirer for us in India.

So, I don't know if there are specific examples where we have disrupted local players. I think, generally speaking, we do grow faster than them. So, it's more of a – maybe a little bit of a war of attrition as opposed to where we just take chunks of the business, because typically what happens is just the gap in capabilities just means that we can grow a lot faster, because we have a lot more value to add and a lot more capabilities to help businesses grow on our platform that maybe others don't have. And that means that over time, our share will grow and theirs starts to fade.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. And if we think about the value to why the moat is so big, I mean the safety factor, the cost to develop something new and the consumer knowing your brand and the merchants knowing your brand, is there anything else? I mean are those four so massive that it just creates a really tough...?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Yeah. I guess, in our view, what is so difficult to replicate are the nodes of the network, the endpoint. So, you have 3.4 billion Visa credentials. And then, now with Earthport added, you can say we can reach in our top 50 markets, which is well over 90% of the volumes. We can now reach 99% of all bank accounts, so – in those

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markets with that acquisition. And so, our reach on that side on sort of the account origination side is sort of unparalleled and would take a incredible long time to replicate.

And then, on the other side, you have 54 million physical merchant locations. You have [ph] ubiquity online (14:05) and even that 54 million is a little bit understated, because people like Square count as one. So, if you think about how much Square has done to build acceptance, the number is actually significantly greater than that number that we report. And you combine those two things together and those end-points and it just becomes very difficult to replicate that kind of scale.

And that's what a lot of partners why they look to us is because if they didn't use us, then especially if you're a multinational, every market you go in, okay, what's the local rail, I've got to connect to them, it's a different technology, the regulations, how settlement works, it can be all different, every country. And that becomes a lot of work and overhead. Again, that's a little bit of a distraction.

So, they look at us and say, okay, with one connection, I can get [ph] global ubiquity (15:03) on both sides of the ecosystem, which a lot of them leverage only one side or the other, but in either case, it's highly attractive for them and that's what has at least allowed us to be an attractive partner for newcomers into the payment system.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. And so, Earthport, you mentioned that as a recent acquisition. Is that something – I guess maybe what do you expect from Earthport for both functionally and even financially? I mean does that triple certain opportunities around the world for maybe more P2P type transactions or maybe you can talk a little bit about that?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Yeah. So, I guess I referenced it a little bit. It's really about extending our reach that even though we have over $2 billion debit credentials in the world, so that – that's – feels like a lot of reach to accounts, but it only got us about 50% of all the bank accounts in the world.

We talked about previously that we are also using our international ATM network, it's called Plus, to reach accounts in Canada, where it's an Interac-branded debit card and we had – so, we are extending our reach with our network assets. And now with Earthport again, we can now cover even accounts that aren't Visa-credentialed or we don't have connections to through our ATM network, which just significantly expands each use case we have in terms of how many places we could deliver it, but also it allows us really to be that payment solution provider for partners.

We're now with one connection through one pipe. We can say we can pretty much get your money anywhere you want it to go. And we'll, of course, use our proprietary network whenever we can, because it's going to be the most effective and efficient. But there may be instances where we need to deliver the funds for the last mile over an ACH network and now we have the connectivity to do that.

So, you don't have to worry about how we get the money there. You just can connect to us, get all the value-added capabilities, the security, the reliability, the services that you would expect to get from Visa and let us worry about how the money gets there. And that's really what the thought process and the rationale for Earthport was.

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David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

Great. And contactless is something that you've talked a lot about. It's really helped proliferate especially small ticket transactions I think in Europe. In the U.S., I think a lot of us already use cards for small ticket items, but how do you see the U.S. benefiting from contactless?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Yeah. So, it's true that we have fairly good penetration in the U.S., but there's still a lot of cash left. So, I think people don't appreciate. There's about $3 trillion of cash still left in the U.S. So, there's still a lot of opportunity. And what we've found in surveying consumers is that even among those people who consider themselves regular card users for transactions under $10, cash still persists and it's still quite commonly used.

And what we've seen now, we have more – we have over 45 countries where at least a-third of all of our face-to-face transactions are contactless. So, we have a lot of data. Australia is sort of the leader at over 90% penetration and places like the UK and Canada, our big markets, over 60% penetrated. But we have 45 markets where at least a-third of the transactions are contactless. And so, we can do all the analysis and we see very consistently that it displaces those small ticket transactions.

Some of it also is like in London was a big part of transit and we were excited that earlier this week, right here in New York, the green line now and with about 20 stations, you can tap to pay and they're going to expand that over the next 18 months for the entire subway and bus system here in New York City. But what we've seen with the transit use cases, that's another place where cash tends to persist and that's also a place where it builds the habit of tapping your card.

And so, in London, we've seen that the people who pay for transit on their Visa card are generally more active in all their spending outside of transit than the people who don't use their Visa card for transit. So, we do see benefits for that. Most of the incremental volume will come in small – smaller transactions, so probably impact transactions more than volume, but that is what we fully expect to happen in the U.S.

It typically takes about two years. So, if you think about where we are in the U.S., what's a little different is that the merchant side is – we're pretty far along. So, we have 80 of the top 100 merchants, but I'd say almost more importantly, last quarter, about 62% of all of our face-to-face U.S. transactions were done at a terminal that was already turned on for contactless. And just a contactless card was not there, but we expect to have over 100 million cards this year and by the end of next year, 300 million contactless cards in the U.S.

And once we – there's enough sort of ubiquity on both sides. That's when it comes together and what we've seen in other markets is then it really takes off. So, that's what we would expect to happen here in the U.S. also.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

And does that change the yield profile at all, like do those show up at all as card-not-present transactions where you might get paid a little more or is it all just the same?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

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Yeah. So, the interesting thing about our business, interchange can vary on a lot of those factors, but our pricing – whether you tap, pay, swipe or scan the QR code, our pricing is the same and whether you paid with Apple Pay or Google Pay or you use PayPal, use Visa Checkout, same economics for us.

So, what we focus on is that we want all of you in this room and obviously the sort of billions of people out there that they prefer to pay with Visa. And as long as they prefer to pay with Visa, then – and – then the user interface, whatever that they prefer, that's their choice as long as they prefer to pay with us, then we're indifferent.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

You mentioned Apple Pay. Has that proliferated the way you expected and do you really [ph] carry the revenue, kind of said the yield (21:45) whether you tap, swipe, whatever, it's all the same anyway?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Yeah. I would say – I mean I don't know if we had specific expectations for what they would achieve, but it has expanded rapidly. It's in – I don't know how many markets they probably said publicly, but I mean it's in many, many markets now. It's quite popular. And again, from our perspective, if that's how consumers prefer to pay, because that's a more frictionless way for them to conduct commerce, as long as they – it's the Visa credential that's in the Apple Pay account, then that's fine with us. We're happy to partner with them and make them as successful as possible, because that will help our business also.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

Got you. And maybe a few numbers questions. So, one thing was Q2 across the whole payments landscape was a little slower growth than normal. And it came down to Easter timing. I think most of your processing day impacts and the timing of the week, the quarter ended. Like just a lot of things all – but how is that – since then, it sounded like things in your last call got a little better. Maybe you could talk a little bit about how things are stacking up now.

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Yeah. I mean, yeah, there were few timing issues that are not impactful if you're looking at the fiscal year. So, one was Easter and that affects the U.S., but also parts of Europe and Latin America and Asia, relatively small impact. The processing days was fairly significant impact in the U.S.

We went back and looked and it's just that – the way the calendar fell was almost the perfect storm and so it's the biggest impact we'd seen in six years. We didn't go back and look further than that, but normally it's just noise in our numbers and this quarter it happened to be very material, but that we will make up in Q4.

So in Q3, the quarter also ends on a Sunday. So, we expect that to correct itself though within fiscal year. Also, gasoline prices were low and that's come back. So, what we saw in the first three weeks of April, if you adjust for Easter I guess, is probably a little bit more representative of what we would expect to see on a go-forward basis, as we called out on our call that some of those things were just timing anomalies and not really representative of the business going forward.

The two things that we do think will persist or we have assumed would persist is our growth in the UK was quite low. That economy is struggling and we're not assuming any improvement for now. And then, this dynamic with

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our dual-branded cards in China, which doesn't really impact the revenue, but impacts our reported volumes in Asia Pacific, that's something that we think will continue.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. And another thing that you called out was the cross-border volatility, the FX volatility was a little bit of a headwind in Q2. And in Q1, I think there was a slight tailwind you called out in the filing. It looks to us when we look at a couple sources that FX volatility has gotten even a touch worse, but it's not that material, but I don't know if you have any comments on that.

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

No. I mean what we saw and I think even Vasant mentioned it on our call that, yeah, volatility was weaker earlier in the quarter. So, that is something that could impact our [indiscernible] (25:18) yields in our cross-border business. So – but it is something that is completely out of our control. So, it is what it is.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Okay. And you have a really simple model from the standpoint of you have volume-based revenue transaction, number of transactions-based revenue in cross-border. So, it's nice and easy to model with a lot of drivers into it. But your transaction fee part of that has grown about 5% faster-ish, most [ph] useful the (25:50) last five years relative to the volume base. And why might that be? Is that where some of the – either mix shift is happening towards higher yielding transactions or what's happening in that drive set?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Yeah. So, there's a few different components for that. So, one is typically as you grow in everyday spending, the ticket sizes tend to come down. So, the more mature the market, typically the lower the ticket size, which might be a little bit counterintuitive, but when you really start to think about it, it's true, because the more mature the market, then it is the $10, $15 transactions that people start putting on their card or $5 transactions, which when you're just starting in a market typically is not true. So, that's one factor.

Another is that that's where a lot of our – any of our value-added capabilities that are per-transaction oriented are there. So, all of our risk capabilities to anything related to fraud and authentication is all run through that area, that line item on the P&L. And that's where there's a tremendous amount of demand for those services. As things have evolved, particularly over the last several years, with the EMV now very widespread around the world, the fraud at the point of sale is incredibly low. And I think you've probably seen some of the announcement we've made where fraud is down 80% in the U.S. where EMV was implemented. So, a lot of that fraud has shifted online.

And people – the bad guys keep getting more and more sophisticated and so there's a lot of demand for those types of capabilities. We also have a large issuer processing business in the U.S. So, we're the largest issuer processor for debit in the U.S. and that is again a per-transaction sort of value-added service that runs through that line. We also have lots of loyalty solutions. So, it's a mix of transactions are growing faster, but then, also a lot of these value-added capabilities we're just seeing more and more demand from also run through that line item.

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David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Okay. Great. And margins have been trending up pretty nicely for a long period of time and it's just a function of incremental – the incremental margin on each transaction is so high, 85%, 90% often it seems like. So, I think you're running around 67%, 68%. Can that just kind of slowly tick up kind of over time still you think?

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

A

Yeah. I mean I guess, our view, well, one, it's just important to note that we don't manage the margins. So, it really is an outcome for us and there's no one on the management team who has a target for margin. In a lot of cases, what we're spending in our [ph] expense base (28:41), what we're investing in is to drive revenue one, two, three years from now, because we don't have a cost of goods sold really. We don't do promotions that can drive sales. So, in some ways, what we're investing in expenses is almost separate from how we drive revenue.

And so, the way we look at it is that we're going to drive revenue as fast as we can and then we're going to make the investments. We have a great business. We definitely don't want to under invest. So, we're going to invest what we think we need to continue that growth into the future years. And there will be periods of time like the last two years where we've grown faster.

So, there are periods of time, I think 2012 was also a time when our expense growth got elevated where there's a huge step-up in the investment to increase our – to move quickly for certain opportunities. But what it does is it really creates that additional investment capacity. So, if you were to take the last two years and we've grown our expenses mid-teens the last two years and if you were to say, well, that's maybe about 10 points higher than the long-term run rate, well, that 10-point difference over that two years means we've added $1 billion of investment capacity to the business.

It doesn't have to initially keep increasing at that rate. That's a huge step-up in their total investment pool, which then now making maybe more grow at a more traditional trajectory that you've seen over time. And if that's the case, then that would mean that margins would continue to expand, because our revenues should grow more quickly than that.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

That's great. Well, I'm hoping about 10 years, you'll be sitting on $1 trillion market cap, right? Just keep it going.

Mike Milotich
Senior Vice President-Investor Relations, Visa, Inc.

Sounds good.

David J. Koning
Analyst, Robert W. Baird & Co., Inc.

Great. Well, that's about all the time we have. Please join me in thanking Mike. And we will host the breakout session nearby as well after this. Thank you.

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