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Visa, Inc. (V)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Visa's fiscal first quarter 2020 earnings conference call. All participants are in a listen-only mode until the question-answer session. 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 your host, Mr. Mike Milotich, Senior Vice President of Investor Relations. Mr. Milotich, you may now begin.

Mike Milotich

Senior Vice President-Investor Relations, Visa, Inc.

Thank you, Jordan. Good afternoon, everyone, and welcome to Visa's fiscal first quarter 2020 earnings call. Joining us today are Al Kelly, Visa's Chairman and Chief Executive Officer, and Vasant Prabhu, Visa's Vice Chairman and Chief Financial Officer. This call is being webcast on the Investor Relations section of our website at www.investor.visa.com. A replay will be archived on our site for 30 days. The slide deck containing financial and statistical highlights has been posted on our IR website.

Let me also remind you that this presentation includes forward-looking statements. These statements are not guarantees of future performance, and our actual results could differ materially as a result of many factors. Additional information concerning those factors is available in our most recent reports on Forms 10-K and 10-Q, which you can find on the SEC's website and the Investor Relations section of our website. Historical non-GAAP financial information disclosed in this call, the related GAAP measures, and reconciliation are available in today's earnings release.

And with that, let me turn the call over to Al.

Alfred F. Kelly, Jr

Chairman & Chief Executive Officer, Visa, Inc.

Mike, thank you and good afternoon, everyone, and thank you for joining us today.

2020 is off to a strong start with Visa's first quarter performance. It's a reflection of our focus on clients to moving money seamlessly and safely. In our time today, let me first touch on our results and then discuss how we're going to grow our core C2B or consumer payments business and capturing new payment flows, which is all part of our network-of-networks strategy.

To start, our first quarter results, we had a terrific quarter and the business is performing well. We reported net revenue growth of 10%. But if you adjust for exchange rates and very low currency volatility, our net revenue growth was approximately 13%. Our EPS growth was 12% or 14% on a constant dollar basis excluding the impact of acquisitions made after Q1 last year.

Key business drivers were largely consistent with the fourth quarter, as we expected. For the first time in our history, total network volume this quarter was over $3 trillion. Payment volume grew at 8% globally, 10% excluding China and the UK. Cross-border volume rose 9% on a constant dollar basis, and we processed nearly 38 billion total transactions on our network, up 11%.

Let me touch briefly on holiday spending, starting with the United States, where growth was similar to the 2018 and 2017 holiday seasons, which were both strong years. Credit growth was slightly better than last year, and debit growth slowed slightly due to lapping tax reform, which had a positive impact on US debit growth throughout all of last year, including the holiday season. E-commerce grew three to four times faster than non-e-commerce. E-commerce also drove more than one-third of all consumer spend, up 2 percentage points versus last year.

Retail spend growth was stronger than last year, fueled mostly by e-commerce. However, that was offset by slower growth in travel and restaurant spending.

To give you a brief sense of the holiday season in the other major markets, Brazil and Canada saw slightly stronger growth than last year. The UK's growth was similar to last year's levels, and growth in Australia slowed slightly.

Now let's look at the core business overall for the first quarter. We are growing our core payments business in three ways: through large clients and markets; number two, making progress to capture the opportunity in emerging and other markets through new partnerships, including wallets and FinTech; and three, all while helping the ecosystem remove friction.

We continue to have significant renewals and wins among some of our largest financial institutions. Visa renewed our issuing agreement with Capital One effective January 1 of this year. We're very pleased to continue our longstanding relationship with Capital One. We recently renewed our agreement with DKB, our largest issuer bank in Germany, and we're looking forward to developing new services and products within this exclusive innovation partnership.

In the Caribbean, we have renewed a multiyear contract with Royal Bank of Canada for credit and debit. This agreement also includes some new debit wins covering 17 Caribbean countries and territories. In Latin America, we're pleased to have won the credit and debit business for Santander in Brazil, Argentina, and Uruguay.

This leadership position with financial institutions also extends to merchants, as we are the leader in co-brand, with 13 of the top 20 portfolios globally. This quarter we continued to solidify our leadership position. In the United States, we were selected for the new Venmo co-brand credit card, a reflection of our strong partnership with PayPal. The opportunity for this product is quite significant, as Venmo has over 52 million users currently.

We're excited to continue growing our longstanding co-brand relationships with Caesars Rewards and Harley-Davidson. Sony has relaunched both of their co-branded credit cards connected with the Sony Rewards program. Together, Sony and Visa are partnering in a number of ways to grow these programs and bring compelling offers to their cardholders. We already have a strong relationship with Costco as their co-brand provider in the United States, Taiwan, South Korea, and Mexico, and just this quarter secured the China co-brand.

In Europe, Visa extended our co-brand partnerships with Norwegian Air Shuttle and [ph] SGroup (6:10) respectively. In CEMEA, we renewed the Emirates NBD's credit business, and half of that portfolio is represented by the Emirates Skywards co-brand program exclusively with Visa, and the rest of the portfolio is bank branded credit.

Our wins are not limited to just large issuers and merchants, as we continue to make progress to capture the opportunity in emerging and other markets through wallets and investments. In Africa, we have recently taken several steps to help accelerate the shift to digital payments. On the credentials side, mobile money wallets are already prevalent across Africa. But without a virtual or physical network credential associated with them, many international online services are unavailable to users. To help solve this problem, we announced a collaboration with MFS Africa, which is Africa's largest digital payments hub, connecting through one API to more than 180 million mobile wallets on the continent to distribute Visa payment credentials across the continent.

In an effort to build acceptance, we recently announced an investment and partnership with Flutterwave, a pan-African digital payments platform that enables multi-payment acceptance and processing. Together, Flutterwave will further scale the consumer payment service called Barter and its merchant acquiring service called Rave through Visa products such as Visa Direct, Visa QR, and virtual cards.

In addition, Visa established a strategic partnership and will acquire a minority stake, equity stake in Interswitch, a company focused on the digitization of payments that processes more than 80% of domestic transactions in Nigeria and sells payment processing across 23 other countries in Africa and operates the largest domestic debit card scheme on the continent with 23 million cardholders. Our partnership will help accelerate Visa deployments of payment experiences, leveraging Interswitch's processing and integration capabilities and scale their bill pay services across Africa.

As we grow our business in emerging markets and with new players across the globe, we're ever-focused on improving the point-of-sale experience, and we do see friction for the entire ecosystem. In the card-present environment, we continue to see meaningful momentum in tap-to-pay, what we consider to be the most friction-free way to pay in person. We have reached a point where one in every three card-present transactions that runs over our network is tap versus one in four a year ago this quarter. This past year, we doubled the number of countries whose face-to-face transactions are at least two-thirds contactless.

Transit continues to be a key user case and an important way to habituate tapping behavior. In New York City on the MCA, Visa crossed 2 million taps in November from the beginning of the pilot and 3 million in January. The MCA recently announced the tap-to-pay expansion to their entire system by the end of 2020. And we are currently pacing at 350,000 Visa taps a week on the MCA, and nearly one in every 10 transactions in the New York metro area is a tap-to-pay on a Visa card. We also launched Africa's first contactless transit system in Johannesburg this quarter in addition to launches in Ho Chi Minh City as well as Taiwan, Sweden, and Ukraine.

In the e-commerce environment, click-to-pay or what we once called secure remote commerce seeks to streamline the digital payment experience across networks, offering greater security and improved sales. You may recall we launched with a select number of merchants in October, and by the end of December more than 40 merchants had adopted the new click-to-pay solution. Now that the holiday season is over, we recently completed the migration of 5,500 US merchants to click-to-pay. We expect to complete the migration of the remainder of Visa Checkout merchants in the United States over the coming months. Additionally, all 50 million consumers who were already enrolled in Visa Checkout were automatically converted to click-to-pay.

Globally, we continue to make progress on securing the ecosystem with tokens. Introduced in 2014, tokens have expanded into 107 countries, equating to 6 billion tokenized transactions in 2019. We now have over 750 million tokens globally. Over the past 18 months Visa signed and is now live with the majority of large e-commerce platform for card-on-file tokenization, including [ph] Adient (11:10), Braintree, CyberSource, PayPal, Stripe, as well as some big e-commerce companies, including Amazon and Netflix, amounting to hundreds of millions of new tokens, which is accelerating the pace of e-commerce transactions now processed over the Visa Token Service. Collectively, we have secured merchant and partner commitments for tokenization in the e-com space that will add up to approximately $1 trillion in Visa payment volume. Putting it together, our core business remains strong, as we continue to win with traditional players, new players, and seek to remove friction.

Outside of our traditional C2B business, we're making progress in capturing new payment flows. In the card-based B2B space, we had several wins in the first quarter. In Singapore, we won the government procurement card for Oversea-Chinese Banking Corporation, or OCBC. With the Singapore government mandating the digitized payments by 2023, OCBC is targeted to capture significant public sector procurement volume.

Within the CEMEA region, Visa signed a partnership with NEC Payments, a digital banking and payments processing platform to expand NEC's regional and international issuing business focused on virtual cards for B2B payments, such as travel and insurance. In Hong Kong, we partnered with Neat, a FinTech offering digital business account services, to be an exclusive partner with Visa to issue virtual commercial cards.

Visa Direct serves P2P, B2C, and even B2-small business, with over 700 million transactions in the first quarter of 2020. This quarter we wanted to highlight significant progress in the B2B cross-border space. MoneyGram announced that it's now live, enabling international transfers that rely on Visa Direct. The new service, which has been available within the United States since September, is starting with transfers to Spain and the Philippines. TransferWise, the global technology company for international payments, will also begin offering its customers the ability to send and receive funds in real time through Visa Direct. The integrated capability, currently available in six countries, including Spain and Poland, will soon be available across more countries in Europe.

Our continued progress with Visa Direct speaks to our network-of-networks strategy for consumers, businesses, and governments to move money to anyone, anywhere. Each new network endpoint, be it a card, a consumer, or a business account or a wallet, compounds the value of the capabilities we offer to partners and improves the customer experience through a single Visa connection.

As I talk about networks, it's hard not to mention Plaid, although I'm not going to cover it in too much detail until the transaction closes. We see Plaid as having the potential to deliver real value to Visa in multiple ways. We have received a number of questions on their revenue model, so I thought I would cover it quickly. Similar to us, they have a usage-based revenue model. Pricing is structured on a pay-per-API call basis and varies by product, depending on the type of financial data consumed by the customers of the FinTech, which speaks to the power of their network. We are truly excited about the acquisition.

To close, we're off to a strong start in the first quarter, with much to be excited about as we look forward. We are deepening partnerships with traditional players in markets and expanding assets with new players. We're removing friction in the ecosystem, and we're making significant progress to capture new flows. This is all part of our network-of-networks strategy as we continue to focus on clients and moving money globally, seamlessly, and safely.

I want to take a quick moment to mention our Investor Day on February 11 here in San Francisco, which will simultaneously be webcast. You will hear from our knowledgeable and deep bench of leaders, who will discuss our view on the evolution of the ecosystem and how we intend to deliver Visa's future growth to our consumer payments business, new flows, and value-added services. The formal presentation should run from about 8:00 AM to 2:30 PM Pacific Time, and we look forward to your participation.

With that, let me turn it over to Vasant.

Vasant M. Prabhu

Vice Chairman & Chief Financial Officer, Visa, Inc.

Thank you, Al, and good afternoon, everyone.

We had a strong start to fiscal 2020, with results coming in consistent with our expectations. Excluding acquisitions and investment gains, constant dollar net revenue and EPS grew by 11% and 14% respectively. Exchange rates reduced revenue growth by over 1 point and EPS growth by approximately 1.5 points. Before acquisitions completed in the last six months, we increased reported revenue growth by approximately 0.5 point and expense growth by approximately 3 points.

Starting in fiscal 2020, we are providing adjustments to our GAAP numbers each quarter to help investors better track ongoing business performance. Non-GAAP results will exclude three items: one, the impact of equity investment gains and losses; two, amortization of acquired intangible assets or acquisitions completed in fiscal year 2019 and forward; and three, certain non-recurring acquisition-related costs. Prior non-GAAP results were also adjusted to reflect this change. This quarter, the impact of non-GAAP adjustments is de minimis. In addition, you will find a helpful schedule on the first slide of our earnings presentation.

In addition to GAAP and non-GAAP results, we provide the growth rate impacts and exchange rates as well as the inorganic impact of acquisitions, in other words, the revenue, expense, and EPS impact that acquisitions had on our reported numbers this year, which were not in our reported numbers in the first quarter last year.

A few highlights from the quarter, key business driver growth rates, payments volume, processed transactions, and cross-border volume were stable and consistent with prior quarters. Net revenue grew 10%. However, the underlying growth trend in revenues is masked by two significant drags related to currencies. First, a stronger dollar reduced nominal net revenue growth rates by over 1 point. Second, currency volatilities were at the lowest level we have seen in over five years. As may be expected, this sharp decline in currency volatility had a significant impact on international fee revenue. If you adjust for the drag from unusually low currency volatility and the drag from the strong dollar, underlying net revenue growth is robust at approximately 13%.

Constant dollar payments volume growth of 8% slowed by 1 point compared to last quarter. This change in trend is driven by differences in processing days when compared to the first and fourth quarters of last year. The processing day impact was over 1 point in the US and several points in Canada. Excluding the processing day impact, Q1 payments volume growth was similar to last quarter, and second quarter service revenue associated with these volumes will be in line with our expectations.

Constant dollar cross-border growth rates, excluding volumes within Europe, were also stable at 9%. Our reported constant dollar cross-border growth rate accelerated 2 points to 9%, as we are now lapping the pan-European e-commerce platform, which reoriented acquiring across countries last year, converting transactions from cross-border to domestic. As we have discussed in the past, this shift had minimal revenue impacted to Visa, as cross-border transactions within Europe have revenue yields similar to domestic yields.

We repurchased 13 million shares of Class A common stock at an average price of $179.71 for $2.3 billion in the quarter. Our board has authorized a new $9.5 billion share repurchase program. With this additional authorization and the $1.7 billion of remaining authorized funds as of December 31, 2019, we have $11.2 billion available for share repurchases. Including our quarterly dividend of $0.30 per share, we returned approximately $3 billion of capital to shareholders in the quarter.

Turning now to our key business drivers and financial performance, payments volume growth in constant dollars was 8%. Credit was up 6%. Debit was up 11%. Growth excluding China and the UK was 10%. As a reminder, Chinese domestic volumes are impacted by dual-branded card conversion, which have minimal revenue impact. US payment volume growth was up 8%, with credit growing 7% and debit 9%. Excluding the processing day impact I described earlier, growth accelerated almost 1 point due to a partial lapping of the Cabela's conversion and modestly higher fuel prices. Underlying consumer spending growth was largely consistent with the last quarter.

International payments volume growth in constant dollars was 8% and 12% excluding China and the UK. Growth in CEMEA remained robust at 22%, with strong growth across Russia and the Middle East. Latin America also remained strong at 17%, driven by some wins and strong performance at existing clients. Asia-Pacific excluding China grew 8%, decelerating over 2 points, primarily due to slow growth in Japan, Australia, and Hong Kong. Europe excluding the UK grew 12%. UK growth remains weak and slowed 1 point after improving in each of the last two quarters.

Processed transactions continued to grow at 11%. Constant dollar cross-border growth of 9% was up 2 points from the last quarter but stable at 9% excluding volumes within Europe. Both travel and e-commerce growth were in line with the last quarter excluding volumes within Europe. Outbound commerce accelerated from Russia, Africa, and across Europe, which was offset by weaker growth out of the US and Asia. Inbound commerce accelerated a bit into the US but decelerated a little into Europe, which is consistent with the weakening dollar compared to the pound and euro. Growth into China and Hong Kong remains weak.

Net revenues grew 10% or 11% in constant dollars excluding acquisitions. The impact of our acquisitions on revenue growth was approximately 0.5 point. Service revenue growth is consistent with the last quarter at 9%. Data processing revenue growth was also in line with the last quarter at 16%.

International transaction revenue grew 9%, decreasing 2 points from the fourth quarter despite a smaller exchange rate drag due to the unusually low currency volatility. Other revenue grew 22%, slowing 13 points from the fourth quarter, as we lapped ASC 606 impacts from last year, partially offset by faster growth in our value-added services.

Client incentives were in line with our expectations at 22.4% of gross revenue, up 80 basis points from last quarter. As we told you in October, we expected client incentives to step up from our fiscal 2019 exit percentage to the lower end of our full-year outlook range in the first quarter due to the level of deal activity this quarter and last year.

GAAP operating expenses were up 14%. Excluding the amortization of acquired intangible assets and non-recurring acquisition-related costs from the four acquisitions that closed in the last six months, non-GAAP expense growth was 13%.

Personnel expense growth is primarily driven by increases in staff to drive our growth initiatives, which we stepped up in the second half of last year. Acquisitions and some non-recurring expenses also contributed to personnel expense growth.

Marketing expenses decreased 1% due to the timing of some spending as well as a reporting change that shifted some expenses to the general and administrative line. The impact of acquisitions added 2 points to non-GAAP expense growth. Exchange rates reduced reported expense growth by approximately 1 point.

Non-operating income/expenses include equity investment gains of $13 million, which we are now excluding from our non-GAAP results. Investment income also includes a small non-recurring benefit, which is exactly offset in personnel expenses, with no impact on earnings. Excluding these non-recurring items, investment income is lower this year due to falling interest rates and lower cash balances.

Our tax rate of 17.7% was lower due to some items that are unique to our first quarter each year. This was anticipated and reflected in our outlook for tax rates this year.

Moving now to our outlook for the second quarter and the full year, first let me share business-level growth for the first four weeks of the quarter. Through January 28, US payments volume growth was 10%, with US credit growing 9% and debit 12%. Processed transactions grew 13%. Cross-border volume on a constant dollar basis grew 8%, or 7% excluding cross-border volume within Europe. Cross-border volumes in the last two weeks of January are negatively impacted by the shift in the Chinese New Year, with potentially some initial effects of the coronavirus outbreak.

As we look ahead to the second quarter of fiscal year 2020, we're assuming stable growth trends on key business drivers, payments volumes, processed transactions, and cross-border volumes. The exchange rate drag on net revenue in the second quarter could be approximately 1 point, 50 basis points better than our prior outlook and consistent with the first quarter, due to some weakness in the dollar since September. More than offsetting this small benefit could be the unexpected drag from currency volatility. The unusually low currency volatility so far this fiscal year continues to persist into January. As expected, client incentives as a percent of gross revenues will climb to the upper half of our outlook range of 22.5% to 23.5%.

Helped by the extra day in a leap year, second quarter net revenue growth rates are expected to be in the low double digits and modestly better than the first quarter. Our second quarter revenue outlook does not reflect the potential effects of the recent coronavirus outbreak in China. It is too early to assess this impact.

Second quarter expense growth is also expected to be modestly higher than the first quarter. As we had indicated in October, expenses will grow at the highest rate for the year in the second quarter, as marketing expenses ramp up relative to a low level of spend last year. Also, as the dollar has weakened, the exchange rate benefit on reported expense growth will be about 1 point, 50 basis points lower than we had anticipated in October.

Our non-operating income/expense in the first quarter had a run rate of around $65 million when you exclude the $13 million gain from equity investments and the small non-recurring benefit I mentioned earlier. The run rate of non-operating expenses will be somewhat higher in the second quarter due to lower interest income as a result of lower cash balances and lower interest rates.

Our tax rate outlook for the second quarter remains unchanged at 19% to 19.5%.

Overall, we are maintaining our outlook for fiscal year 2020. I will mention a few adjustments and trends we've been monitoring. On the net revenue front, we are still expecting low double-digit net revenue growth in constant dollars. Based on current exchange rates and future expectations, the currency translation drag could be at the lower end of our previous 1 to 1.5 percentage point range at approximately 1 point. The four acquisitions we have completed in the past six months are still expected to add around 0.5 point to net revenue growth.

As we highlighted in October, a significant factor impacting fiscal year 2020 net revenue growth is the unusually high volume of renewal activity. In fiscal year 2019, we renewed 30% of our payment volume, with 15% renewed in the fourth quarter alone. And we indicated fiscal year 2020 renewal activity could be front-loaded, with another 15% to 20% of payment volume renewed in the first half. Since then, it has become a pattern that renewal activity in fiscal year 2020 could be even higher, with three to four large unplanned renewals now under discussion, which would bring this year's level of renewal activity almost on par with last year.

We are pleased about this since in most of these situations, we will most likely not only renew our existing business but could also gain a larger share of these clients over the term of our new contracts. One major client renewal is already complete, and the others could get done in the next two or three months. As such, we now expect current incentives as a percent of gross revenues to be at the high end of our outlook range of 22.5% to 23.5% in FY 2020.

Excluding acquisitions and last year's MDL-related special item, our outlook assumes core expense growth in the mid to high single-digit range in constant dollars, or 7% to 8%. This climbs to low double-digit growth when you add in the four acquisitions we have closed on in the past six months, which contribute 3 to 4 points to expense growth. Based on current exchange rates and future expectations, nominal expense growth is likely to benefit by 1 point. As such, our expense growth for the year is expected to be in the double digits, which is about 50 basis points higher than we expected in October.

As I indicated earlier, non-operating expense had a run rate of approximately $55 million in the first quarter. This expense will move modestly higher in each successive quarter this year due to declining interest income from lower rates.

Our full-year outlook for tax rates remains unchanged at 19% to 19.5%. Q1 tax rates were lower than the full-year outlook due to some items that are unique to our first quarter each year and were largely anticipated in our full-year outlook.

Excluding the four acquisitions, our outlook for adjusted fiscal year 2020 EPS constant dollar growth remains in the mid-teens built off fiscal year 2019 EPS of $5.40. Four acquisitions are expected to dilute EPS by $0.05 to $0.06, a 1 point drag on EPS growth. Based on current exchange rates and future expectations, exchange rates could reduce EPS growth by approximately 1 point.

Including the acquisitions and exchange rate impacts of around 2 points, our outlook for adjusted fiscal year 2020 nominal EPS growth would be in the 12% to 14% range. We still expect the fourth quarter to be the highest EPS growth quarter.

Our fiscal year 2020 outlook does not include any impact from the Plaid acquisition. We will update our outlook when we have more clarity on the timing for closing on the transaction. When we announced the acquisition, we gave you some preliminary estimates of revenue and earnings implications for fiscal year 2020 and 2021.

With that, I will turn this back to Mike.

Mike Milotich

Senior Vice President-Investor Relations, Visa, Inc.

We're now ready to take questions, Jordan.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Jason Kupferberg from Bank of America. Your line is now open.

Jason Kupferberg
Analyst, BofA Securities, Inc.

Q

Hey. Good afternoon, guys. So I just wanted to start on the incentive side. The guidance change here is really only 0.5 point, and people were previously modeling the middle of the range. So I'm just wondering if you expect to make up for that 0.5 point through better gross revenue, or does it feel more like you just may land that revenue slightly lower within that overall unchanged low double-digit guidance range, especially since the currency volatility has fallen off, as you guys pointed out?

Vasant M. Prabhu
Vice Chairman & Chief Financial Officer, Visa, Inc.

A

A couple of things, Jason. We'll see how incentives play out for the year, but the way it looks right now, renewal activity will be higher. And so we are signaling that it could be at the upper end of the range. And as you said, if people are in the middle of the range, that's a point higher. On the other hand, we are signaling that if exchange rates stay roughly in the range therein on where people are expecting, that is about at the low end of the range too, so you pick up some of it there.

In terms of currency volatility, we were able to absorb most of it in the first quarter and still got very close to, as you saw, what our expectations were. We are factoring that into our second quarter outlook. What it's going to be for the second half, I think we'll wait and see. It's not something you can predict further out, and time will tell.

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

A

Next question?

Operator: Our next question comes from Dan Dolev from Macquarie. Your line is now open.

Dan Dolev
Analyst, Macquarie Capital (USA), Inc.

Q

Hey, guys. Thanks for taking my question, so a quick question on cross-border. It looks like a nice uptick. Can you maybe talk a little bit about that? Thank you.

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc.

A

Remember, last year, Dan, you had a number of things going on, especially at the back end of the quarter, with the government shutdown, Brexit, US-China trade talks, et cetera. So we were expecting some uptick off of some of those factors that had a negative impact on cross-border at the time. And so we're back up in what I think we would expect to be a fairly normal range at this point.

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

A

Next question, please.

Operator: Our next question comes from Tien-Tsin Huang from JPMorgan. Your line is now open.

Tien-Tsin Huang
Analyst, JPMorgan Securities LLC

Q

Thanks so much. Everything looks really consistent here, but just looking at the regional volumes, just a couple questions or clarifications. On the Asia front, it looks like it slowed to the 4% zone. I'm curious. What's the outlook here based on what you see? And then with Europe, pretty stable, [ph] softer a touch (34:43), low end of 8% to 9% range, but I know you guys have made a lot of investments there. What are your expectations for Europe? Can you sort of break out of this zone based on some of the investments you've made? What do you see there? Thank you.

Vasant M. Prabhu
Vice Chairman & Chief Financial Officer, Visa, Inc.

A

I might start, and Al I'm sure will add. In Asia, we highlighted three areas. Japan was really more of a quarter-over-quarter comparison. There were some changes in consumption taxes in Japan that seemed to push some spending into the period ahead of the tax going up, so it was pushed more into the last quarter, and so we don't think that's an ongoing issue. The other one was Australia. Australia, you had some of the wildfire impact, and that seems to be one of the bigger factors there. And last is Hong Kong, and you saw what some of those are. We have seen impact in Hong Kong from some of the protests going on. So that was pretty much it. Across the rest of Asia, the trends are very good.

In Europe, the UK is a big chunk of our business, and the UK has been very weak and actually slowed through the elections and had a relatively weak holiday season and slowed by a point in the quarter. If you take the UK out, growth was at a pretty healthy 12% in the rest of Europe.

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc.

A

I'd add two points, Tien-Tsin. One is the consumption tax that Vasant referred to, now the government has decided to rebate some of that consumption tax when people do contactless transactions in Japan as part of the government's push on cashless going into the 2020 Olympics in Tokyo. So that's actually is going to turn out to be – hopefully will be a good thing not only to stimulate spending but to stimulate tap-to-pay spending.

The other point on Europe, as Vasant rightly pointed out, the UK has been a bit of a drag for us, but we've been extremely focused on the continent, and we've had some good wins in FinTechs and some good renewals. And those things are in the pipeline, and I feel pretty good about where Europe is going to head over the next couple of years in terms of growth.

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

A

Next question?

Operator: Our next question comes from Darrin Peller from Wolfe Research. Your line is now open.

Darrin Peller
Analyst, Wolfe Research LLC
Q

Hey. Thanks, guys, just a couple of quick ones. One is on the improvement in volume we're seeing in January seems to really underscore the comments you made around like nuances in calendar Q4, like the processing day. If you can, comment on what you're seeing in terms of the consumer given, are these improvements into January just timing, or do you actually see a healthier type of spending trend?

And, Al, just one quick follow-up also is around the rebates and incentives. Given so many are being done now, can you just comment on the types of returns you're expecting to see for those? Are these longer contracts than they used to be? Are they coming with more value-add offerings? Something along those lines would be great.

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc.
A

So I think, Darrin, other than in the UK, the consumer has held up pretty darn well. Our volume in this last quarter, when you factor in the processing day change, which is kind of a bit of an anomaly, but if you look in September, the last day of September in 2018 was a Sunday, and a lot of merchants acquire its whole volume on a Sunday. So what ended up happening, a bunch of one day's worth – a lot of volume for one day got pushed into the first quarter of 2019. We did not have that same phenomenon this past quarter because the last day of September this year was a Monday. So we simply had a dynamic that we had a harder grow-over. And so when you actually adjust for that, our growth quarter over-quarter was pretty similar. So in general, I think the consumer has held up quite well, and there's no reason to see it go down other than, again, depending upon where the coronavirus ends up going and who knows at this point.

Just to be clear, when you asked about rebates and incentives, when I was referring to the rebate, that was the rebate being given by the government in Japan. I don't know whether that's what you were referring to. But in general, we are trying to obviously strike the right balance in terms of incentives that we do in deals, try to make many of them, as many of those incentive dollars growth-oriented as possible, so that as a partner's volume picks up, their incentives pick up, but we're also getting the associated volume with them.

And I just think – there are probably no guarantees. We obviously push for contracts that are as long as possible. To some degree, most of them kind of fall in a five to seven-year cycle. Every once in a while, there are some 10-year deals. And then there are issuers that like to do deals every couple of years, and those would tend to be more of the issuers that are dual-issuers. So it's always a bit of a balancing act to try to get to the right level. But I think we try to structure these incentives in smart ways where they're growth-oriented, they're focused on consumption of different numbers of Visa products, and try to build relationships with issuers that go well beyond just an issuing relationship to encompass Visa Direct, to encompass tokenization, et cetera.

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

Next question?

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

Bryan C. Keane
Analyst, Deutsche Bank Securities, Inc.
Q

Hi, guys. I wanted to ask about Capital One. I know Mastercard also announced a renewal with Capital One. So maybe you could help us sort out how that contract breaks and if this is a net positive for both networks.

And then just secondly, Vasant, on expense growth, I think your comments last quarter was it was expected to be similar to the fourth quarter, which I think was around 11.4%, and it came in a little bit higher. Was there any pull-forward in expenses because I think operating margins that the Street were expecting were a little higher than they came in? Thanks so much.

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc.

A

Bryan, let me just – a quick point on Capital One and then I'll let Vasant comment on acquisitions. Look, Capital One has been a classic dual-issuer, and it always depends on what portfolios each network happens to have and how they perform at any given point in time. But they're a big, terrific bank with a lot of innovative people on their team. We love working with them. And so it's a good thing for us, and I'm sure that's why I would say it's a good thing for them as well.

Vasant M. Prabhu
Vice Chairman & Chief Financial Officer, Visa, Inc.

A

Expense growth was a couple of points higher than we might have expected. Some of it was exchange rates. So as you saw, the exchange rates were somewhat better than we – the exchange rate impact was somewhat better than we expected on revenues, which means on the expense side it was somewhat worse. I think that was about a point. And as I indicated in my comments, there were a few other non-recurring types of things that added another point. So in general, there weren't any real surprises there or pull-forward of investments. It was just a couple of these kinds of items.

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

A

Next question, please.

Operator: Our next question comes from Trevor Williams from Jefferies. Your line is now open.

Trevor Williams
Analyst, Jefferies LLC

Q

Hi. Good afternoon and I appreciate you taking the question. This is a little bit higher level. But I'm curious internationally, with a couple government-backed systems like Mir in Russia and TROY in Turkey that mandate domestic processing. I guess first, just how you see your role in the economics you can earn in both of those markets over the longer term. And then second, more broadly, if you're comparing today's backdrop to, I don't know, five or 10 years ago, just what kind of threat you guys think nationalist payments agendas could pose to the international business going forward? Thanks.

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc.

A

Trevor, some of these domestic processing platforms and domestic schemes are not terribly new. Our objective is to work closely with both regulators to make sure it's an even playing field, and then work closely with our clients to make sure that we get our fair share of business. Many times, our processing network of VisaNet actually, just plain and simple, has a lot more richness to its various offerings. And we've had cases where banks see that and prefer to process with us because of the investment, the level of security, the level of innovation. So we'll continue to be up against this kind of backdrop. But I think it's still allowing us to grow at healthy levels, and we're trying to partner in a thoughtful way as much as we can.

Your question about the backdrop on nationalism today versus 10 years ago, I think you'd have to say it has become a little bit more pronounced, simply because it wasn't nearly as prominent a decade or so ago. But again, I think our job is to continue to innovate, work closely with regulators and with our clients to have as much of an even playing field as possible and continue to show that processing on Visa or minimally partnering with Visa as your scheme has good advantages to it that people want to work with us.

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

Next question, please.

Operator: Our next question comes from Harshita Rawat from Bernstein. Your line is now open.

Harshita Rawat
Analyst, Sanford C. Bernstein & Co. LLC Q

Hi, good afternoon. Thanks for taking my question. Al, if I look at the long-term history of your growth versus your largest competitor, it's been quite stable. More recently though, over the last one or two years, you've seen some delta open up between your [indiscernible] (45:32) metrics and your peers. So can you talk about the drivers of this? And more importantly, if we look out the next few years, can we expect the gap to narrow because of what you did with FinTechs, internationally, and also the strength in Visa Direct?

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc. A

Thank you, Harshita. Look, both companies have performed extremely well on a number of dimensions. If you look at this most recent quarter, we're very pleased with our results. And look. Mastercard had a great quarter, and they've had some good quarters the last couple of years, as have we. That said, a few points. First of all, volume metrics don't have any standards attached to them, and it's always difficult to do an apples-to-apples comparison between the two companies and really understand what's going on fully in terms of the volume.

On the revenue side, the revenue delta has been a bit smaller in a number of the recent quarters. There are huge mix differences in our business. We've got a very big position in the United States, and we wouldn't trade that for the world. It's just plain and simple a much more mature market that doesn't have the same high double-digit, big double-digit, even over 20% kind of growth prospects to it. But we're certainly pleased to have the partnerships with the banks that we have and the position that we have in the United States.

The last point I'd make is that my expectation is based on the investments that we're making in value-added services, in new payment flows, in working with FinTechs, working with neo-banks, working on engagement with our existing customers, building out our acceptance footprint that I'm quite confident that over time we'll close that gap and continue to perform very well for our investors.

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

Next question, please.

Operator: Our next question comes from Lisa Ellis from MoffettNathanson. Your line is now open.

Lisa Ellis
Analyst, MoffettNathanson LLC

Q

Hi. Good afternoon, guys, a question on Visa Direct. You mentioned the greater than 700 million transactions in 1Q. You've highlighted previously that Visa Direct was growing in the triple digits. So I guess question one, is it still growing at that rate? And then also, how are the yields tracking in Visa Direct? Is it sort of comparable to debit? I know there's a lot of cross-border in there too.

And last one. I'll really do Visa Direct. I promise. But you mentioned a few new partnerships. As you complete the Earthport integration, what are some of the major use cases for Visa Direct you're seeing rolling in as we move through 2020? Thank you.

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc.

A

So first of all, Lisa, our growth in Visa Direct remains incredible. It didn't quite get to triple-digit growth this quarter, but it was very, very high double digits and close to that level. In terms of yields, we really haven't talked much about it, but to your point, Visa Direct is going to increasingly have more cross-border transactions that will run over that platform and our push platform. And that is obviously a very good thing for us.

I think when we talk about use cases, I think they're going to fall into some of the same buckets they fall in today, P2P, disbursements, remittances. And I think that those businesses will continue to grow. You'll see on Investor Day that we'll highlight a good number of Visa Direct use cases with quite a few specific examples, so we look forward to taking you through it on February 11.

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

A

Next question, please.

Operator: Our next question comes from David Togut from Evercore ISI. Your line is now open.

David Mark Togut
Analyst, Evercore ISI

Q

Thank you, good afternoon. Given the ongoing weakness you're seeing in UK volumes and the incremental 1 point deceleration you called out, could you update us out on your growth pivot, moving employees out of London and into some of the higher-growth markets of Italy, Poland, and Germany? And when might this growth pivot accelerate your volume growth in Europe?

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc.

A

David, we don't have any active plans to move people out of the UK. We're just plain and simple as we grow the business adding employees on the continent. We're certainly adding the vast majority of employees we would add in that region are in market offices on the continent. I'd also comment that I'm certainly hopeful now that at least there is some clarity around the Brexit outcome that we might find a new normal in the UK that would allow their economy to pick up. Certainly, I was in Davos last week, and certainly the officials in the UK that I talked to feel as if that it's on the verge of starting a comeback. We'll see what happens.

In terms of the continent, in many of these markets we've been behind, plain and simple. And over the last four or five quarters, we've been – after we got the integration behind us, we started investing in fairly significant ways. We're winning deals and trying to build our credit business, build our acceptance footprint. And so it takes a little bit of time for the pipeline to work its way into the numbers. But I think over the next couple of years, we'll start to see some real payback for the progress there we're making now on the continent in Europe.

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

A

Next question, please.

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

Sanjay Sakhrani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thanks. I appreciate your commentary on the coronavirus, but I was wondering if you could dimensionalize the cross-border China business and maybe any impact it may have and sort of how you can address it.

And then secondly, on the three to four unplanned renewals, is there any context as to why it's happening? Are banks are choosing to renew early? Thanks.

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc.

A

So on coronavirus, let me start with this. It's certainly just too early to know. When we look at our numbers, we see some declines, but Chinese New Year this year was earlier this week, January 25. And last year in 2019 it was February 5, and spending slows around the holidays. So given that we're about 12 days earlier this year, it's hard to know what's really impacting the volumes at this stage.

That said, there's definitely going to be impact. When planes are being halted both in and out of China and you're probably reading as we are that companies are telling their employees to stay home, so even for the e-commerce world, planes are staying home, who's picking goods and shipping them? So I think for sure there will be some impact. But we'll have to see how pronounced it gets and how long it goes. I'm not in the predicting game for it at the moment.

In terms of the early renewals, what tends to happen is right about half the time it's us and half the time it's the client who says as we're talking to them about deepening our relationship or we're talking to them about all the dynamics that are going on in payments, and/or we're talking to them about building a deeper relationship by them consuming more and more of these capabilities and solutions, if a deal is going to be up in a year or a year and a half or two years, it's usually no longer than that.

But if the deal is going to come up in say a year and a half to two years or less, one of the two of us, us or the client, will say why don't we just get our deal done and extend it out a number of years so that we can focus on all of these capabilities. And we can work together on trying to grow the business versus starting down a path where a client is starting to consume more Visa products and then we have to halt everything while our teams on both sides go into negotiation mode, and it just slows down the wheels of progress. I think what's happening because payments is just more complex than it was four or five years ago and the number of offerings is greater than it was even two or three years ago, I think that this is what's kind of driving this. I don't want to call it a phenomenon, but driving this occurrence.

And this year, as Vasant said in his remarks, there are four decent-sized financial institutions that were not scheduled to be up this year. They were not built into our numbers or incentives. One of them is already done. I referred to it in my remarks, which was Santander and the deal we did with them in South America. There are three others where there's live discussion going on right now, and it's too early to tell whether a deal definitely gets done or not. But my expectation is it's more likely than not. At least a couple of them that were not planned will get done.

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

A

Next question, please?

Operator: Our next question comes from James Faucette from Morgan Stanley. Your line is now open.

James E. Faucette
Analyst, Morgan Stanley & Co. LLC

Q

Thank you very much. I wanted to ask about the acquisitions that you've been doing and perhaps the change in reporting, what that may indicate. In the past, Visa has done a lot of investments in companies and FinTechs, et cetera, even before FinTech was coined as a term. But it seems like you've picked up, at least in the last year, the pace of acquisition. Is this part of a – should we expect more acquisitions and you to be more active in actually acquiring companies than you have been in the past, or is this maybe a little bit anomalous? I was just wondering how you're thinking about incorporating some of the development that happening outside Visa into Visa proper.

Vasant M. Prabhu
Vice Chairman & Chief Financial Officer, Visa, Inc.

A

I think Al may add some more things. We'll talk more about this at Investor Day, but just a quick response to that question. I don't think we are deliberately stepping up the level of acquisition activity or investment activity in some kind of change of direction. And our approach has always been we build any core capability, and if it is faster or cheaper or the talent that we can get from the outside that would be valuable, then we would consider acquisitions. And there's a logic to every one of those we did.

On the investment side, typically when it's complementary capabilities, we prefer to partner. And we do lots and lots of partnerships, as you know. Our business is built on partnerships. Occasionally, we get into a situation where a company may like us to invest or we want to invest because we do want to enhance our relationship, get closer, have a better commercial agreement, get some exclusivity, and so on. The reason the volume has gone up to some degree is because, as you know, there's a lot of activity nowadays in terms of companies with business models and capabilities that are very valuable to us, either as capabilities for us to own or capabilities to partner with. So it reflects what's going on in the marketplace too. And the pace of activity will depend on exactly applying the criteria I just mentioned. It could go up if we find more that meet our criteria, or it could go down.

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

A

Next question, please.

Operator: Our next question comes from Dan Perlin from RBC Capital Markets. Your line is open.

Daniel R. Perlin
Analyst, RBC Capital Markets LLC

Q

Thanks. Al, you went through a pretty exhaustive list of breaking down core versus new flows, and then reduced friction is kind of three big tenets of growth. What I'm trying to I guess parse out is how do you break those out? Is core like 80% of the growth as we think about the next couple of years, then layering in these other two to three assets, or how should we kind of parse out that as we think through all of these opportunities for you? Thanks

Alfred F. Kelly, Jr
Chairman & Chief Executive Officer, Visa, Inc.

A

Again, Dan, on Investor Day, we'll talk a lot about all three of these categories. To be very honest, we don't have a set mix that we're trying to get to across the three items that you cited. We're trying to make sure that we do as well as we possibly can against all three to try to make sure that we're delivering sustained, good levels of revenue growth. And some of it will depend on what's happening at a particular point in time and economies and where we end up choosing to put investment dollars. So there's a lot of factors that go into it. But we're not setting out to hit some certain mix. We're setting out to do a really good job in our core business, to try to extend the business through new payment flows and value-added services, and with the acquisition of Plaid, extend the business and our network-of-networks business even further. So that's really what our objective is, Dan.

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

A

And one last question, Jordan.

Operator: Our last question comes from Dave Koning from Baird. Your line is now open.

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

Q

Hey, guys. Thank you. When we look at cross-border, the reported volume growth all through last year was pretty slow, and I know that has to do with just currency, right? But the revenue growth was way, way above volume growth. This quarter volume growth has gotten better, but the disconnect, I guess, between volume and revenue has gotten smaller, like that gap between volume and reported revenue growth has gotten smaller. Why is that, and should it be closer? Should it stay closer like that throughout this year?

Vasant M. Prabhu
Vice Chairman & Chief Financial Officer, Visa, Inc.

A

The delta between volume growth and revenue growth are driven by a variety of factors. The most important are currency related, right? Most of the time, the delta is driven by currency impacts. Clearly, pricing plays a role, so there was some pricing in there that was causing revenue growth to be faster than volume growth. Currency effects can then move it one direction or the other.

And then when volatilities move in a big way, in this quarter we had a very big move. If you look at volatilities, we're at five-year lows now not seen since 2014. Historically, those have corrected over time, so that we think is a transient thing. But when volatilities declined, the revenues related to those volatilities are also in that line. And this quarter, those had a big impact. If volatilities were the same year over year, our revenue growth would've been fairly comparable to last quarter on the international fee line.

Mike Milotich

Senior Vice President-Investor Relations, Visa, Inc.

Thanks, Jordan, and thank you all for joining us today. If you have any additional questions, please feel free to call or e-mail our Investor Relations team. Thanks again and have a great day.