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Visa, Inc. (V)

Q3 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Visa Inc.'s fiscal third quarter 2014 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 also 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, Visa, Inc.

Thanks, Charles. Good afternoon, everybody, and welcome to Visa, Inc.'s earnings conference call today. With us today are Charlie Scharf, Visa's Chief Executive Officer, and Byron Pollitt, Visa's Chief Financial Officer.

This call is currently being webcast over the Internet. It 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.

Let me also remind you that this presentation may include forward-looking statements. These statements aren't 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 10-Q, which you can find on the SEC's website and the IR section of our website.

For historical non-GAAP or pro forma related financial information disclosed on this call, the related GAAP measures and other information required by Reg. G of the SEC are available in the financial and statistical summary accompanying today's press release. This release can also be accessed through the IR section of our website.

With that, I'll now turn the call over to Byron.

Byron H. Pollitt

Chief Financial Officer, Visa, Inc.

Thanks, Jack.

Let me begin with my usual callouts and observations. First, we continued to experience solid constant dollar payment dollar growth in the low double-digit range both in the U.S. and internationally. That said, we see no signs yet of any acceleration in economic recovery, and cross-border volume growth remains soft in the mid-single digits.

Turning to revenue, as expected and previewed on our call last quarter, revenue growth further moderated, growing 7% year over year on a constant dollar basis or 5% nominally, which reflects the two percentage points of FX headwind we have experienced since the beginning of the fiscal year. As a reminder, the current Q3 is lapping 17% nominal revenue growth in the prior year quarter, which benefited from a number of favorable one-time adjustments.

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It is worth noting that the international revenue grew at only 1% this quarter despite cross-border constant dollar volume growth of 7%. While unfavorable FX is a partial explanation, the bigger impact is a significant reduction in currency volatility, which has a direct impact on our international revenues. We expect both of these factors to reverse over time.

Looking ahead to Q4, we expect a rebound in nominal revenue growth on the order of two to three percentage points compared to Q3. This rebound is about two percentage points less than we anticipated at the time of our last earnings call, primarily due to a one percentage point drop in cross-border transaction growth and unusually low levels of volatility across a broad range of currencies. So that means for the full fiscal year 2014, we now expect revenue growth in the 9% to 10% range on a constant dollar basis, with guarded optimism that the moderation in cross-border volume growth has troughed. After FX impacts, that translates into nominal revenue growth of 7% to 8%.

Client incentives for the fiscal third quarter came in lower than we had anticipated at our last earnings call, due primarily to the timing associated with several major deals which have now been either signed or we expect to sign in the fiscal fourth quarter. With this in mind, we are narrowing our full-year guidance for client incentives as a percent of gross revenue to around 17% from the prior range of 16.5% to 17.5%. Let me also point out that, mathematically, this puts the fourth quarter at north of 19%.

In terms of EPS, on a fiscal year 2014 basis, we are narrowing our guidance for diluted earnings per share to be in the 17.5% to 18.5% range.

Lastly, we remain confident in our future growth prospects and fully committed to returning excess cash to our shareholders. To this end, we repurchased a total of 5.6 million shares during the quarter at an average price per share of $207 and change, resulting in a total cost of $1.2 billion. This leaves an outstanding open-to-buy of $1.9 billion at the end of June. And as always, we will take advantage of market movements to repurchase at attractive prices.

Now let's turn to payment volume and transaction growth. Let me start with what I stated last quarter. Though we are seeing a sustained economic recovery, there are no signs yet of acceleration either domestically or internationally. Global payment volume growth for the June quarter in constant dollars was 11%, a one percentage point decline from the March quarter. The U.S. grew 10% and international grew 13%.

Drilling down further for the June quarter, U.S. credit growth was 12%, slightly higher than the 11% in Q2. And through July 21, U.S. credit improved to 14% growth. U.S. debit was 8% in Q3, a one percentage point improvement compared to Q2. Through July 21, U.S. debit is flat at 8% growth. Taken together, U.S. payment volume growth through July 21 was 11%, up one percentage point from the Q3 level.

Global cross-border volume delivered a 7% constant dollar growth rate in the June quarter, slightly down from 8% in the March quarter. U.S. and international both grew at 7%. Through July 21, cross-border volume on a constant dollar basis held steady at 7% growth, with the U.S. growing 6% and international registering 7% growth. For the June ending quarter, the sequential downtick of one percentage point in cross-border was broad-based and spread across China, Russia, Ukraine, Venezuela, Argentina, and the Middle East, as you might expect given political tensions and the early onset of Ramadan. Speaking of Ramadan, when interpreting the Q4 cross-border trends, keep in mind that the timing of Ramadan in 2014 benefits August at the expense of July.

Transactions processed over Visa's network totaled $16.7 billion in the fiscal third quarter, an 11% increase over the prior-year period, same growth rate as Q2. The U.S. grew 9% while international delivered 20% growth.

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Through July 21, processed transaction growth moderated to a 9% growth rate. The notable drop in July is largely due to the lapping of significant debit wins in Brazil in June 2013 where our debit processing penetration went from zero to well above 50%.

Now turning to the income statement, net operating revenue in the quarter was $3.2 billion, a 5% increase year over year, driven primarily by growth in service and data processing globally and, as mentioned earlier, negatively impacted by a two percentage point foreign currency headwind.

Moving to the individual revenue line Items, service revenue was $1.4 billion, up 9% over the prior year, and was driven by moderating global payment volume growth. Data processing revenue was $1.3 billion, up 11% over the prior year's quarter, based on solid growth rates in Visa processed transactions both in the U.S. and internationally. As highlighted earlier, international transaction revenue was up 1% to $860 million versus 7% constant dollar volume growth over the prior-year period, as a result of a broad range of currencies experiencing volatility well below the ten-year trend line, in contrast to the year-ago quarter when volatility was near record highs. We would expect a return to a more normal volatility pattern in the coming quarters.

Total operating expenses for the quarter were $1.1 billion, down 3% from the prior year. Certain expenses have slipped to the fiscal fourth quarter while some specific personnel and professional fees, though sequentially higher than the prior quarter, were comping off of higher levels of expense in the year-ago period. We expect elevated marketing investments in Q4 more comparable to Q2 levels tied to the FIFA World Cup in combination with significant investments in the support of the recent rollout of Visa Checkout.

Operating margin was 64% for the third quarter, in line with our guidance of low to mid-60s%. Capital expenditures were $109 million in the quarter. At the end of the June quarter, we had 624 million shares of Class A common stock outstanding on an as-converted basis. The weighted average number of fully diluted shares outstanding for the quarter totaled 628 million.

Finally, given our year-to-date results and our outlook for the balance of the year, let me recap our 2014 full-year guidance: constant dollar net revenue growth of 9% to 10%, which when combined with two percentage points of negative FX impact, yield nominal revenue growth of 7% to 8%; client incentives around 17%; operating margin in the low to mid-60s%; tax rate between 30% and 31%; EPS growth in the 17.5% to 18.5% range; and free cash flow of about $5 billion.

Before I turn the call over to Charlie, let me provide some early perspective on fiscal 2015. In short, we are approaching 2015 bullish on the long term but cautious in the short term. Here are some of the underlying observations and assumptions in forming 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 transactions appear to be troughing in the 6% to 7% growth range on a constant dollar basis. As perspective, we know that these growth rates can recover significantly without notice and that the notable declines in Latin American growth rates lap in January 2015 and the market declines related to the Russia/Ukraine crisis will lap in March. Everything else equal, once these events anniversary, the pickup in cross-border growth could be in the two to three percentage point range.

As to currency volatility, I'm not sure when this trend reverses. We only know from a historical perspective we are overdue for a correction, and such shifts in trend can be quick and sizable. Consistent with past strategies, we remain focused on growing revenue through converting more cash volume to electronic payments, with a growing emphasis on digital. In addition, we expect the successful growth in our client payment volumes for both issuers and merchants to result in higher levels of client incentives as measured by percent of gross revenues.

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Turning to Russia, while this situation is still very much in flux, we anticipate being a part of a commercial solution that will be implemented in 2015, which will likely result in the loss of about $50 million in domestic Russian processing revenue.

Looking further down the income statement, we see no step function change in our tax rate at this time. That said, we are working diligently on more fully realizing our opportunities related to foreign tax credits.

Finally, consistent with past practice, we expect to deploy our excess cash flow in 2015 to service our dividend and to repurchase our shares.

In sum, we remain bullish on the future, but recognize that in today's economic environment we must work through several challenges before we can once again resume more normalized rates of growth. As is our practice, on the Q4 earnings call, we will provide more color on 2015.

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

Charles W. Scharf

Chief Executive Officer & Director, Visa, Inc.

Thank you very much, Byron. Byron did cover the financial results in a fair amount of detail, but I thought I'd just pass on a few quick thoughts.

First of all, the quarterly results did come in where we expect. The revenue growth being impacted by the year-over-year comps, the strong U.S. dollar, and the tepid growth from the cross-border payment volume in these specific geographies was what we expected. And we reiterate that we are confident that these headwinds we do not feel are permanent. More importantly for the long term, global payments volume and processed transactions remain healthy and strong. Also, our issuer contract pipeline is very strong. So all in all, we're gratified to be able to deliver 15% earnings per share growth given the environment and what we've discussed.

Let me now turn for a second and talk about Russia. As you all know by reading the newspapers and watching the news, the situation continues to evolve. The recent additional sanctions have not forced us to curtail business with additional clients. And as of today, our domestic and international business continues. This includes completing term sheets and contracts regarding our brand relationships during this quarter with significant Russian clients, which we're gratified about. But we continue to focus on developing a domestic processing solution, and we're actively engaged with the Russian government and the Russian banks to develop a commercial solution which will allow us to continue to serve our Russian clients. The most limiting provisions of the new law go into effect in October, and we are working to have a solution implemented by that time. Having said that and as Byron mentioned, we do expect to lose a portion of our domestic processing revenues over the next year, which will reset our base from which we expect to achieve good growth.

Now let me turn for a second and talk about what we're seeing in our client activity around the globe. We did have a good quarter regarding issuing co-brand contracts. Just a few significant examples, in the U.S. we renewed our credit card relationships with American Eagle Outfitters and Hyatt Hotels and Resorts.

In Canada earlier this month, we launched a new relationship with CIBC for Tim Horton's, which is the largest QSR in Canada. It's a significant co-brand offering and a no-fee rewards base afforded by innovative product features and real-time rewards. It's called the Double Double Visa card. It leverages a first of its kind dual-button technology that combines a CIBC Visa credit card for payments with a classic Tim Card for rewards. Cardholders simply press the CIBC Visa button on the front of the card to pay for their everyday purchases anywhere Visa is

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accepted, or they can chose to press the Tim Card button and then use the same card to redeem their Tim Cash for their favorite coffee and menu items at Horton's. The new card also offers the convenience of Visa payWave and the security of chip-and-PIN technology that consumers in Canada enjoy today. On the issuing side we also renewed a multiyear agreement with the Royal Bank of Canada, an important and longstanding client of Visa.

We also signed a number of other significant new multiyear agreements around the globe. In Australia, we will be the exclusive card network for Woolworths Money's credit card partnership. Woolworths is Australia's largest retailer. In China, we renewed our credit partnership deals with China Industrial Bank, China Minsheng Banking Corporation, and Shanghai Pudong Development Bank. In Korea, we signed a new debit partnership agreement with Hana SK and a new credit/debit agreement with Woori Card. In Saudi Arabia, the Saudi British Bank will convert their debit card portfolio to Visa from a competitor. And Banque Saudi Fransi has renewed their credit, debit, and prepaid agreement. In the UAE, Visa signed a new credit deal with Mashreq Bank, including an exclusive card for high net worth individuals.

Turning to CyberSource for a second, we've discussed the weaker growth over the past few quarters. Increasing our rate of growth here will take some time. It's one account at a time. And as Byron mentioned, we are investing here to rebuild to higher growth rates. We recently announced a strategic global partnership with Amadeus, a leading technology provider for the global travel industry. Amadeus has integrated CyberSource's fraud management system, Decision Manager, into the Amadeus payment platform, which can help travel organizations globally accept more bookings while identifying potential fraudulent transactions and lowering operational costs.

Turning to payment security for a moment, earlier this year we formed a payment task force and partnership with other networks, merchants, issuers, acquirers, and device manufacturers. We see real collaboration here, which is terrific. We continue to work through a common roadmap for enhanced security in the U.S. Topics include EMV, tokenization, end-to-end encryption, and coordinated communications. The group is working very well together, and we would expect the group to have some things to talk about publicly in the near future.

Let me talk for a few minutes now about our work in digital commerce. First of all, there's a lot of clutter in the market about who's doing what in the digital payment space. It can be confusing for sure. We have a very specific point of view and a set of strategies here. Simply put, we are keenly focused on achieving the same success in the digital world that we have had in the physical world. This means focusing on tangible activities in the marketplace that help accelerate digital commerce, with Visa as a platform partner. As an aside, our card-not-present volumes today are growing three times as fast as card-present, which we feel is still just a fraction of the opportunity in this space.

We are focused on two different but related things: number one, bringing digital payments to the physical world; and number two, enabling digital payments in the connected world. To do this, we are materially changing how we do business. Historically, we would only allow access to our capabilities through issuers and acquirers, and for them it wasn't particularly easy. Today, we're simplifying access for our traditional partners, but we're also enabling a much broader set of partners to access these platforms in ways we have not allowed historically so they can build experiences that use our payment capabilities. This includes partners such as merchants, technology companies both big and small, mobile operators, device manufacturers, other payment companies, social networks, and the broader application developer community. Including these partners means exposing web services so they can connect with us.

To help drive innovation, last week we opened a 100,000 square foot innovation center in San Francisco. This space is all about collaboration. It's one of the series of physical spaces which we will have which will provide a physical environment where we can sit side by side with partners traditional and new, big and small to create experiences using our capabilities.

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We're also investing in younger companies such as DocuSign and Loop. As a group, investments like these, and they're more to come, keep us close to innovators in our space. Being part of the dialogue is important. Bear in mind, we're not looking to pick exclusive winners here, but we do want to enable a series of people who we think can help drive payment electronification.

To support our digital activities, today we announced Visa Digital Solutions. This suite of services extends our support for mobile payments to enable retailers, financial institutions, and developers to create new ways to pay via mobile devices. Specifically, we published specifications and software development kits to make it easier for financial institutions, merchants, and developers to create new ways to pay using our products on mobile devices using Visa payWave and QR codes. We have also published APIs and SDKs to enable merchants and developers to embed simplified payments within their web and mobile sites as well as the mobile applications using Visa Checkout, which I'll talk a bit more about in a moment. These services are now available, and there will be more coming throughout the year.

The second category is aimed at protecting consumer account information. Our new token services are part of this. I've mentioned this before, but most people have focused on the security benefits of tokenization, and they are real. But with tokens, new players and importantly non-traditional payment providers such as developers and merchants can build applications that access payment information in a safe, secure manner not possible before. This means on digital devices wherever there's an Internet connection regardless of the form factor, including ones that don't exist today, developers will be able to integrate Visa payment capabilities. Merchants, developers, and banks will start offering token-based payments in September of this year. We are also launching a more robust developer center in early 2015 that will extend the capabilities we expose to the developer community.

In addition to all of this, we're creating a suite of services to enable banks to issue and manage Visa accounts in secure virtual clouds. This again allows developers to create commerce opportunities to integrate our payments products and capabilities wherever there is an Internet connection.

Last week we launched Visa Checkout, replacing V.me in the marketplace. We've learned a lot over the past year and a half through candid conversations with issuers, acquirers, and merchants in addition to consumer research on the topic of digital wallets and digital acceptance. Our goal is simple. We want our clients and their customers to be able to use our products in the digital world as easily as they can in the physical world. This means we've designed Visa Checkout to be the Visa card in the digital world. It means a simple buying experience for consumers, clear branding for issuers, and simple integration with merchants. It also means preserving the roles in the payments chain as they exist today. Visa Checkout accomplishes all of this. For the consumer, they can pay with their username and password with just a few clicks wherever they see their card and Visa Checkout online. For the issuer, clear branding throughout the checkout experience, and for the merchant, easy integration of a product, one which will help increase the rate in which sales are consummated online. As I said, Visa Checkout is simply a Visa card in the digital world.

As I mentioned earlier, with this launch a new mobile software development kit is also available, allowing developers to quickly build and implement an in-app checkout experience for iOS and Android-based devices.

We will drive broad awareness for Visa Checkout through a significant advertising campaign recently launched in the digital and social channels and on television later this year. The campaign will feature participating merchants and a broad range of consumer offers and promotions.

We're thrilled with our partners who are part of the launch. On the financial institution side, they include more than 180 financial institutions and organizations, big and small. The list includes U.S. issuers such as Bank of

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America, BB&T, BBVA Compass, CSCU, which is the card services for credit unions, Chase, Citi, ICBA Bancard, Navy Federal Credit Union, PNC, Regions, U.S. Bank, and Wells Fargo.

We're also thrilled to have great merchants as partners in our launch, some of which are the following: Neiman Marcus, Staples, Pizza Hut, United Airlines, Petco, Wine Enthusiast, Adorama, Joseph A. Bank, Rakuten, Ticketmaster, and Live Nation. Over 170 merchants are live in Australia, Canada, and the U.S., representing approximately $20 billion in total addressable payment volume. The sales pipeline is also very strong, with over 40 merchants at term sheet and/or negotiating master service agreements, representing an additional $37 billion in addressable volume, including some great sizable brands.

In summary, our job at Visa is to help grow commerce by providing a platform to integrate what we think is the best payment brand and set of capabilities in the world into new buying experiences simply and securely. These experiences will certainly make it easier to pay by eliminating physical cards over time, but the driver of behavioral change will be the experiences that can now be created on mobile devices that cannot be created on plastic because the mobile device is connected and interactive, and these experiences will become the real reason to pay digitally over time. We believe that you'll start to see these experiences in the near future and are excited about what they mean for everyone involved in commerce and will be an important part of our future. We look forward to discussing these specific experiences and their positive impact to Visa over the coming quarters.

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

QUESTION AND ANSWER SECTION

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

Jason A. Kupferberg
Analyst, Jefferies LLC

Q

Thanks, guys. I just wanted to ask about the cross-border a little bit more, since obviously that remains a high priority focus area for folks. Can you give us any commentary whether some of the slowdown has been more on the consumer side relative to the commercial side, and then just any thoughts on the gap between your growth in this metric and that of your biggest competitor, at least through the March quarter. We don't know what they've done for the June quarter yet. But it just looks like that gap has gotten a little bit bigger. I'm curious if you guys have done any market intelligence to get a better understanding of that. And is there anything structural there we should be thinking about?

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.

A

So let me start off with the first part of the question. It's very corridor-specific. So let me just highlight a few of the corridors that we saw the deceleration in cross-border from Q2 to Q3, and many of these will come as no surprise: generally, from Russia to the European countries; from Argentina, Venezuela to the European countries; the European countries to Ukraine; Russia to Ukraine; Ukraine to the European countries. So from that standpoint, those are the key corridors that moved the needle. We know that it is pretty broad-based. And in this case, many of these are just situationally specific.

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With regards to the second part of your question, recognizing that Visa Inc. does not have Europe, we are comfortable that at least half the difference in cross-border growth rates is attributable to Europe, and the remainder we have under study. We also know given the ebb and flow of certain portfolio movements that some of that is country-specific, and we are very focused on reversing those trends in the coming quarters.

John R. Carsky
Head of Global Investor Relations, Visa, Inc.

A

Next question?

Operator: Thank you, sir. Our next question comes from Sanjay from KBW. Your line is now open.

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

Q

Thank you. I guess I had a question on the hedges and the volatility observation or point. Could you talk about what would happen if volatility doesn't come back into the FX market? Does that serve as a headwind for a period of time then?

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.

A

So let me separate first hedges and volatility because the two are completely independent of each other. When we speak of hedges, this is simply basically a 12-month program where we try and dampen the fluctuations in FX when we translate net revenue or earnings positions earned in foreign currencies back into our financial statements. Cross-border is impacted but to a modest degree. And these are hedges in the traditional sense simply put in place to dampen the volatility of naturally occurring changes in currencies relative to the dollar over time.

The volatility is a different animal. Every year – if we look back over the past year, we will have performed currency translation services for over $150 billion U.S. in value in order to facilitate the settlement of transactions where a Visa card whose account is denominated in one currency is used in a country where the currency is different. And so over the course of the year, as I indicated, we do over $150 billion of those kinds of currency translation services.

We earn a very small spread on those transactions. The way the spread is calculated, it's an algorithm that is based on the actual volatility of a currency in a given day. That volatility is something we have studied over a long period of time. There is during the course of a year often quite a bit of volatility, but the amount of volatility tends to revert back to a mean over time. So we would expect what we're seeing. And as an example, if we were to look at the month of June, June had the lowest volatility that we have seen in 15 years. So from that standpoint, we view this much more as of the moment that it should resume back to some sort of normalized volatility levels, which has been our experience since we've gone public. And that's how we're anticipating this trend for the future.

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

Q

Thank you, great.

John R. Carsky
Head of Global Investor Relations, Visa, Inc.

A

Our next question, Charles?

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Operator: Our next question comes from Jim. Jim is from Goldman Sachs. Your line is now open.

James E. Schneider
Analyst, Goldman Sachs & Co.

Q

Good afternoon, thanks for taking my question. I was wondering if you could elaborate a little bit on your commentary regarding incentives for fiscal 2015. Specifically, how many of your top ten [indiscernible] (35:03) clients are expected to come up for renewal next year?

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.

A

So what we would typically do on the Q4 call is give you a sense of the full-year expectation for incentives, so you can expect that on the Q4 call in October. It is our practice to give incentive projections or guidance on a yearly basis, not by quarter. And we would characterize our pipeline of deals as: it was healthy this year. It's a healthy pipeline of renewals next year as well. And the expected impact, we'll characterize that in a range and share it with you all on the fourth quarter earnings call.

John R. Carsky
Head of Global Investor Relations, Visa, Inc.

A

Next question, Charles.

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

Darrin D. Peller
Analyst, Barclays Capital, Inc.

Q

Thanks. Charlie, just first a higher level question. You mentioned in your remarks and I think in the press release that longer term you believe Visa should be able to grow revenue in the double-digit range. Can you just highlight and perhaps rank for us what the key drivers you think would be that would enable the growth to improve given the higher base from which you're growing now?

And then maybe just near-term, on the near-term side, Byron, as a follow-up to that question, I guess what people are trying to figure out is if this higher level of incentives in fourth quarter is actually new business that could drive part of that acceleration into next year. Thanks, guys.

Charles W. Scharf
Chief Executive Officer & Director, Visa, Inc.

A

So let me start with this, which is, again, the way we look at our numbers is we look at what our revenue growth is, excluding the items that we talk about here as headwinds. And again, I said this in my remarks. We do believe that these headwinds are not permanent. And so if you just look at the headwinds that we've had in the foreign currency translation, in the currency volatility, the impact on the comps year over year, and this growth in cross-border payments, which we should point out can move either way very, very rapidly, and we've got amazing data to back that up, when you just back out these headwinds which we do believe are temporary, our growth underlying all of that is still very, very strong, which you can see in the transaction processing growth and the overall payments growth.

So as we talk about generating reasonable returns over a period of time, there's the long term, which is affected by the things we're doing in the digital world, which we think is certainly helpful. But then there's this other defined

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period once we get through these headwinds. And the issue we have is we don't know exactly when they're going to reverse, but we're very confident that they will.

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.
A

With regards to the second part of your question, recognizing that a typical contract would last five years, some longer, we enter into contracts with the expectation that they will drive growth over that five-year period. How we structure the incentives makes a big difference with regards to what kind of growth we may or may not see in the first year. As we've talked about over the years, some of the deal renewals entail more meaningful upfront payments that from a GAAP standpoint we might have to record more fully in the income statement versus amortize over the term of the contract. And so there's a lot that goes into how you structure a deal and then how it's translated onto the books. But since Charlie's comment was based over and we see ourselves in the longer term returning to double-digit revenue growth, the answer is we would expect these deals to build on a foundation that would drive growth over the term of the period that would enable us to achieve that objective.

John R. Carsky
Head of Global Investor Relations, Visa, Inc.
A

Our next question, Charles?

Operator: Yes, sir. Our next question comes from Moshe from Credit Suisse. Your line is now open.

Moshe A. Orenbuch
Analyst, Credit Suisse Securities (USA) LLC (Broker)
Q

Great, thanks. Charlie, when you talked about tokenization, could you talk about whether that is something that is going to bring in revenues into the system? And will those be revenues that go to the networks? Do they get shared? Could you talk a little bit about whether those – are they just going to be something that's going to be an additional form of security?

Charles W. Scharf
Chief Executive Officer & Director, Visa, Inc.
A

The answer to this is yes, it's an additional form of security, for sure. We think of it as driving more network volume that we otherwise wouldn't able to get because other people can now participate and embed payments in different applications and experiences out there because it's safe and secure because of the tokens. This isn't a question of getting paid specifically for tokenization. It really is about driving more volume through our issuers or our merchants and ultimately to us as well as part of that.

John R. Carsky
Head of Global Investor Relations, Visa, Inc.
A

Next question, please.

Operator: All right, our next question comes from Smitti from Morgan Stanley. Your line is now open.

Smitti Srethapramote
Analyst, Morgan Stanley & Co. LLC
Q

Great, thank you. Charlie, I just wanted to follow up on a statement that you made earlier about your new strategy on the digital front. I thought I heard that you said you all allowed new ways for parties to access your network

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directly. So does this mean that potentially merchants and other technology partners will no longer need to connect to your network through an acquirer? And if that's the case, who will settle the transaction?

Charles W. Scharf
Chief Executive Officer & Director, Visa, Inc.
A

No, I didn't say that. What I said was that we are exposing the capabilities so that different parties, including merchants, can embed Visa payments into their experiences. But very importantly, it preserves the role that issuers, acquirers play in the system today. So what we're trying to do is – again, historically we've had great relationships with issuers and acquirers, still do. But anyone who is trying to build an experience or an application would have to then go through multiple issuers, multiple acquirers to get that experience to market in a meaningful way. And by exposing our capabilities directly to them, it allows more people to be creative relative to helping drive digital commerce in a way that uses our payments as a platform for them. But it keeps the flow of information, the flow of data, and the flow of economics the same as it is today in the four-party system.

Smitti Srethapramote
Analyst, Morgan Stanley & Co. LLC
Q

Great, thanks for the clarification.

John R. Carsky
Head of Global Investor Relations, Visa, Inc.
A

Next question, Charles.

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

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

Hi. I just wanted to follow up on your comments on 2015. I didn't hear any comments on the operating margin. Do you still expect to get leverage in 2015 on the operating margin?

And then secondly, just an update on the Chase migration volume that is expected. Are we a quarter of the way through? I'm just trying to get a sense of how much we're through on the migrating of that volume. Thanks so much.

Charles W. Scharf
Chief Executive Officer & Director, Visa, Inc.
A

Before Byron answers the question, everyone asks about operating margin. We really have to think about incentives as a meaningful cost of doing business here as well.

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.
A

And the two should be viewed in combination. With the exception of what happened to our incentive line after the Great Recession, that has gradually moved up in terms of incentives as a percent of gross revenue. And in a way, that is very similar to dealing back margin. We don't have a combined metric to summarize the two, but the two very much should be linked because incentives are a form of price reduction or price discount.

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So with regards to margin outlook, as you know, it is our practice when we talk about margins and the outlook for the year to do that on the Q4 call. And since we as a company have never solved for margins, margins have been an outcome, we're in a much better position to talk about that at the fourth quarter call when we have our plans in place and we're at least a bit better informed about what the economic drivers are liable to hold in store for us in the coming year, so if we can indulge your patience for three months.

Charles W. Scharf
Chief Executive Officer & Director, Visa, Inc.
A

And even beyond the three months because obviously the way we think about where we are is we are not in an environment where it's very easy to predict the next quarter or the quarter after that just given what's going on in the world and these trends that we've seen which affect our revenue numbers materially. Again, as I said before, we feel very confident that the headwinds will dissipate. We know that at some point the economy will be more helpful across the globe. What we don't know is the timing. And we certainly can't sit here today and tell you what it will be a year from now, and that is still only halfway through next year. So as the world evolves and as these issues evolve and we get closer to the time period, it's obviously by definition easier for us to talk about it.

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.
A

Just a quick word on Chase. The current quarter's results, to the extent that they include any of the conversion, it's not material, remembering this will hit the service fee line and we record the service fee line on a one-quarter lag. Before we see much impact from the conversion, it will be really be for us the December-ending quarter, which will be the first quarter of the next fiscal year. But at the present, no material impact on the quarter's results and frankly not a material impact on the Q4 results either.

John R. Carsky
Head of Global Investor Relations, Visa, Inc.
A

Next question, Charles.

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

Tien-tsin Huang
Analyst, JPMorgan Securities LLC
Q

Great, thanks. I just wanted to I guess clarify what's driving the softer revenue outlook for the fourth quarter. I just wanted to make sure I caught it correctly. It sounds like it's lower cross-border plus lack of volume acceleration. I don't think it's incentive-driven. I just wanted to clarify that.

And then the question I wanted to ask was actually on Visa Checkout and the strategy there to get consumers signed up and to use Visa Checkout versus whatever, PayPal or any other digital payment method you can think of because we've been getting questions all day today about Apple and other initiatives, so I was just trying to understand how that's going to play out versus something else. Thanks.

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.
A

Okay, so let me take the first part. With regards very specifically to the Q4, which is really how we're then going to then finish out the year, compared to where we were on the third quarter call, what's different primarily is a downtick in the cross-border, so you have that right, and continued depressed, historically depressed volatility levels from a currency standpoint. And for those, our position has moved a bit more conservative from where we

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were on the prior quarter call. It doesn't have anything to do with incentives because what didn't get booked this quarter, our assumption is that it will get booked in the current quarter ,and we're already signing deals to validate that. And remember, our incentive guidance was 16.5% to 17.5%, and we've narrowed it to about 17%, so we're right down the middle of the fairway.

Charles W. Scharf
Chief Executive Officer & Director, Visa, Inc.

A

But as we sit here and just think about from this quarter to next quarter, we are not assuming any kind of meaningful change in these headwinds that we've talked about, which again are possible and will happen; we just don't know the timing. And just given the math that Byron said, next quarter's incentives will be higher than this quarter's incentives, and he talked about that during his remarks. And the Visa Checkout question, I don't remember what the exact question was, the question – Tien-tsin, are you still there?

Tien-tsin Huang
Analyst, JPMorgan Securities LLC

Q

Yes, I'm here. I just wanted to clarify, Charlie, just the strategy to get consumers signed up to for Visa Checkout versus all the other stuff that's out there, PayPal and I guess Amazon is talking about – I was just trying to understand how you'll solve the consumer side of the equation. And then I guess if I get a chance here, if you don't mind, just if you can address Apple and iWallet or whatever, all of the press that's been talked about with your partnership there, I think that would be great and how that would fit with your digital strategy. Thanks.

Charles W. Scharf
Chief Executive Officer & Director, Visa, Inc.

A

Sure. So listen, I think on the answer to the first question about which my words is why Visa Checkout for consumer and how are we going to activate the consumers around the world to use this product as opposed to something else. From our perspective, what's different about this versus the other things that you mentioned are the relationships that we have with banks. Again, we've got 2.2 billion cards around the world. And when we think about the people who were willing to support this with their names in a press release, a bunch of them come to a launch event that we had here, these are amazing names. These banks talk to their clients regularly. And over the next six months, you'll start to see banks do different things to enable their customers in a very proactive way to use Visa Checkout.

So it's one thing for us to sit here and say we're going to go try and do it. That would be very, very difficult. The reason why we're confident that we'll be successful is because we do it in partnership with the banks because it's their clients. We provide support. Our marketing and advertising is going to do that. Again, we've got some really neat stuff in the digital and social channels. As Byron mentioned in his remarks, we intend to spend a significant amount in marketing, including TV, as we go into the back-to-school season and then again leading up to the Christmas season. So it's going to be hard not to know what Visa Checkout is and why you should have it. And so we're pretty excited about that.

And Apple, I'm not going to address anything specifically out there. But again, we've said this before. We talked to a whole range of people who historically weren't doing significant things in payments and those that are. And we're very excited about some of the things that we're talking to potential partners about. And again, over the next three months, six months, nine months, we hope some of those things will actually be in the in the marketplace, and you'll be as excited about them as we are.

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John R. Carsky
Head of Global Investor Relations, Visa, Inc.

A

Next question, Charles.

Operator: The next question comes from Bob from William Blair. Your line is now open.

Robert P. Napoli
Analyst, William Blair & Co. LLC

Q

Good afternoon. I just wanted to follow up on a few of the 2015 comments. When we talk about – you talked a lot about currency volatility. Can you maybe put some numbers around that? Is that 1% of revenue effect versus your guidance? And then in talking about 2015, your tax rate, I was a little – the full-year tax rate for this year, you're expecting it flat. And then you're still getting double-digit payment volume growth, as people think about revenue and higher, is the double-digit payment volume growth, do you still expect to be able to attain that next year?

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.

A

So let me start off. On the currency volatility, we're not on record talking about specific amounts. But this is, as you can imagine, a part of – it's pretty fundamental to the Visa global acceptance proposition that we be in a position to perform currency translation services. So this is something that we have done forever, and we do it in a way that actually delivers a pretty attractive cardholder proposition. As a part of the disclosures for someone that receives a Visa card, they are told that they are guaranteed a wholesale rate. And I'm hard pressed personally to think of any other situation where a consumer or cardholder would have available to them a wholesale currency translation rate. That's what we do. We take a very small spread on that to cover our operations, and it's related – how much the spread is is related to currency volatility. I have talked about that from time to time on earnings calls. It rarely has this level of impact. But as we said earlier, we're at levels of currency volatility that we haven't seen in 15 years.

Tax rate, so with the guidance this call, we have given very specific guidance of 30% to 31% and have indicated that next year not to expect any step function rate. We did have an important tax adjustment last quarter that represented both a catch-up and a permanent ongoing reduction in our tax rate. Because there was a catch-up, one might naturally wonder whether that impact is something that would be one-time and then the rate might naturally gravitate back up in the following year. Hence, in my remarks I mentioned that we are hard at work in fully realizing foreign tax credit opportunities. And so we expect that to help inform the rate for next year and underpin the comment that we don't at this point expect any step function change in the rate.

With regards to double-digit payment volume growth, gosh, certainly on a constant dollar basis, this is the level of payment volume growth that is being produced with pretty anemic growth in economies. And so as we look at the payment volume growth, this is one of those factors that we think looking forward have certainly more upside than downside. One never knows for sure, but one I think would agree that the economic growth we've been experiencing over the past several years has been pretty anemic and hopefully nowhere to go but up.

Robert P. Napoli
Analyst, William Blair & Co. LLC

Q

Great, thank you.

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John R. Carsky
Head of Global Investor Relations, Visa, Inc.

A

Next question, Charles.

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

Craig J. Maurer
Analyst, CLSA Americas LLC

Q

Yes, good evening. Charlie, I wanted to ask you theoretically about the future with technology and the changes you're bringing to the online world that are absolutely focused on better security, as you said. What are your thoughts about the sustainability of card-not-present interchange rates for banks when clearly those rates were predicated on higher fraud levels?

Charles W. Scharf
Chief Executive Officer & Director, Visa, Inc.

A

Listen, I'm not going to talk about what we would be thinking about anything specific on interchange on a going-forward basis. What I will remind, and I know, Craig, we've talked about this, but it's always a good reminder to everyone. I don't know of a lot of industries out there that price their services for anything other than the value received. And the value received from products like ours in the card-not-present world is extraordinary. And we knew and we know the number of businesses that wouldn't exist if it wasn't for our products. And if people wanted to go back to a COD world, we could certainly try that.

So, as we sit here and continue to improve security and to continue to build payments into people's applications, all with the point of view of helping them grow, we're going to be making sure that we think about looking at both sides of the equation, looking at what goes to the issuing side and to the acquiring side, what is fair in terms of value received. And that could possibly evolve over time, but again it's the value equation on both sides.

John R. Carsky
Head of Global Investor Relations, Visa, Inc.

A

Next question, Charles.

Operator: Okay. Our next question comes from Chris from Sandler O'Neill. Your line is now open.

Christopher R. Donat
Analyst, Sandler O'Neill & Partners LP

Q

Hi, thanks for taking my question. Byron, I just wanted to explore one thing on your comment about the Chase business not appearing in the numbers in a material way. I was just looking at the volume from credit, that was 12% year on year, U.S. credit 12% year-on-year growth in the June quarter, and you said I think 14% through July 21. Does that reflect any of the Chase business, or is there some other dynamic going on there?

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.

A

It does, but as it relates to conversion, it's really not a material driver of those numbers. As the conversion picks up speed later in the year, we would expect to see more of an impact, but currently it's not material.

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John R. Carsky
Head of Global Investor Relations, Visa, Inc.

A

At this point, Charles, we have time for one last question.

Operator: And our final question comes from Ken from Merrill Lynch. Your line is now open.

Kenneth M. Bruce
Analyst, Bank of America Merrill Lynch

Q

Thanks, good evening. Thank you for all the color you've given us on the issue around the cross-border. I'm hoping you might entertain one more question. You had pointed out last quarter that some of these quarters had witnessed slowing volume. Obviously, there are quarters that picked up, and that's going to work out as it works out. On the actual foreign exchange volatility side, has this been something that has been – that volatility has been dampening over time and it just became much more acute in the most recent quarter? If you look back, what would be the right reference point to think about in terms of what normalized volatility would look like, if you would?

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.

A

Honestly, we don't have a very good explanation. When you look at the patterns of volatility, they are often event-specific. During the period where Greece was rumored to be potentially exiting the euro, there was quite a bit of volatility in the euro, and that cross-referenced against quite a few currencies. We thought that we would see some volatility return during the week where a Malaysian airliner was shot down. We had an event in Gaza. And Portugal was in the news with regards to the stability of its participation in the Euro bloc. And yet those types of events which would have historically created volatility didn't. The one common denominator that we've seen over the past several quarters is just an exceptionally strong dollar, and our hypothesis is that that may have something to do with it. But honestly, we've done a lot of analysis and looked for a lot of correlations and just haven't been able to find one that offers much in the way of a respectable R-squared.

Charles W. Scharf
Chief Executive Officer & Director, Visa, Inc.

A

But as Byron said, what we saw recently are the lowest levels that we've ever in 15 years.

Byron H. Pollitt
Chief Financial Officer, Visa, Inc.

A

So you can defy gravity for a while, but not forever. And so in looking at 15 years' worth of data, there are periods of calm that occur regularly during the course of the year. And then again, looking at that timeline of data, these can reverse very, very quickly, often without notice. And so if past is prologue, then it's just a matter of time before we hit an inflection point and it moves back to something closer to the mean.

John R. Carsky
Head of Global Investor Relations, Visa, Inc.

And with that, we'd like to thank everybody for joining us today and if you have any other follow-up questions, please feel free to call myself or Victoria [Hyde-Dunn]. Thank you.

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

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