27-Feb-2018

Visa, Inc. (V)

Morgan Stanley Technology, Media & Telecom Conference

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MANAGEMENT DISCUSSION SECTION

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

We'll go ahead and get started here, because we have a short amount of time with Visa's CFO, Vasant Prabhu. Thank you very much for joining us.

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

Thank you.

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

I'm James Faucette, the U.S. Payments Analyst from Morgan Stanley. And before I get started, I have a quick disclosure to read. Please note that all important disclosures including personal holdings disclosures and Morgan Stanley disclosures appear on the Morgan Stanley's public website at www.morganstanley.com/reserachdisclosures or here on the site at the registration desk.

Still, very pleased to have Vasant here. I think this dovetails incredibly well with the conversation that we have just wrapped up with the VC panel and a lot of that focused on Bitcoin and cryptocurrencies. Vasant, do you have any preamble remarks you want to make, before I launch into my prepared questions?

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

No.

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QUESTION AND ANSWER SECTION

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

Q

All right. Thank you. Well, I want to start maybe with that crypto-type question. And I guess my question as it relates to your business is with all the news stories around cryptocurrency, blockchain, et cetera, are you seeing a meaningful reevaluation of the payment processes, whether it be consumer where you've long been exposed, or in business, and who is doing that, and where do you see the best opportunities to adopt what Visa does well to the some of the use cases being proposed by crypto advocates?

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

A

Sure. Look, as far as cryptocurrencies are concerned, and I wasn't here for the earlier session, so I'm not sure exactly what I'm walking into. Look, I mean, nobody really knows whether cryptocurrencies are a medium of exchange, a store of value, or a unit of account. Not obvious right now whether they're a medium of exchange or a store of value. They are a unit of account, but you've got to have the stomach for how much they fluctuate. Clearly today, we don't accept cryptocurrencies, we are only working with legal tender, as we like to call it, which may offend those who are doing otherwise.

As far as Blockchain goes, the technology behind cryptocurrencies, we've always been interested in that as have lots of other people. We see it as a technology that we would be happy to deploy in our own business if it makes sense. We have an investment in a company that has been in Blockchain for a long time and we have a product out there right now that has got a fair amount of interest from people. This is a product called B2B Connect that allows you to do cross-border payments using a distributed ledger technology, to the extent that we can do more with it we would. I have, from our own tech people, an estimate I got recently was that it costs about 100 times as much from an energy standpoint to process a transaction using Blockchain than it does using our current network. So -

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

Q

And I'd actually bet that it's higher and going higher than even 100 times. So -

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

A

Right. And that's why so far at least it's applicable as a technology for what I would call lower volume transactions than sort of the billions of transactions that we end up, we do in our business. So I think, time will tell, I mean, the cryptocurrencies are being tested right now by the markets, they'll come out of that and we'll have a better sense of what these are all about. There are some, people do use Visa cards and other cards to buy cryptocurrencies on other exchanges, there may be some changes coming there based on some of the things that the banks want to do with that. So, it's early days. We watch it very closely and we're definitely very much interested in the underlying technology.

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

Q

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Right sure. So we'll kind of leave that at least for now, I want to go back to kind of the core business and recently at your Investor Day which I guess was almost eight months ago now, seven months or eight months ago.

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

A

Yeah.

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

Q

You made a – you personally made a very convincing case that there were multiple potential drivers that could accelerate Visa's growth and you didn't put a timeframe around it, I mean you just said hey look at all these potential things that are building. What are the key sources of that inflection or what are the key sources – would be the key sources of that inflection were it to occur and when will it manifest itself do you think in the financials?

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

A

Yeah look, we think that it's an exciting point in Visa's history and over this entire time [ph] we were one of the original (5:11) companies that was in the business of digitizing things at a time when being digital wasn't even cool 50 years or 60 years ago. And here's another one of about four inflection points we've had in our history and why is that? Well, one has been underway for a while which is essentially the shift from face-to-face commerce to e-commerce and that's been powering us for quite a few years right now. And the benefit of that is that e-commerce is growing four times or five times as fast as face-to-face commerce. And then any time a transaction moves from face-to-face commerce to e-commerce, the propensity for it to be a Visa transaction is twice as high.

What's the effect of that, the effect of that is that our payment volumes are growing substantially faster than global economies. Remember we are a facilitator of consumer spending and in a normal situation without changes going on, you would expect that we would grow about in line with global nominal GDP. But even in the developed world, we're growing three times as fast as global GDP largely driven by the underlying trend towards e-commerce. That's part one and we are well into that and the last holiday season we shared some numbers with you on our call, we saw this trend continue to be incredibly healthy another three point gain in share through e-commerce channels.

Part two then is m-commerce and the proliferation of smart devices. And what the proliferation of smart devices does is some fundamental things to our business as you can imagine, that every smart device is a point of payment or a point of acceptance. And with tokenization technology, the card is digitized and is embedded into the smart devices. Which means that you now have many, many more use cases that can be facilitated, thanks to the proliferation of smart devices.

And then you layer onto that the Internet of Things that is coming and you can embed payment credentials into any device whether it's a car or a refrigerator or you name it. And we have demonstrated all of these and then you have devices now able to utilize your payment credentials to pay or be paid. The cost of acceptance is dropping with QR codes and any smart device being a point of acceptance, you saw that with dongles and Square in the U.S., and I'm sure you'll hear from them. But, as you go outside the U.S., it's QR technology that is taking over. You go from having to put an expensive dedicated point of sale acceptance terminal with landlines to something with no landlines, no point of sale terminal, just a QR code you print, everything is done on a smart device, faster to get merchants up and running at substantially lower costs.

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You put all this together and we see a massive proliferation in the ability for people to digitize cash and every one of these prior inflection points over a 10 year or 15 year period after that we saw a 10x increase in the volumes in our business, and we see similar things happening. Now when did it show up? Well, I would argue it's already shown up in the sense that we are growing three times faster than what nominal global GDP is. Will it accelerate from here? I think that depends on what's going on now in the m-commerce space, which is the next wave, and then of course the Internet of things which is still coming, and the Internet of things is still in its very, very early stages.

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

Q

Very early, right.

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

A

Yeah.

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

Q

Yeah and I think you make an interesting point there. I mean it's not happenstance that I tend to refer back to Visa versus Crypto, because one of the things that I find when I talk to investors is, a surprising proportion of investors I talk to don't own Visa or don't own what I think is enough Visa, because they are worried about disintermediation risks from things like cryptocurrency, and I think your point on like QR codes and driving down that cost of acceptance is really important, because for some people that decided, hey, one of the initial investment cases around crypto is to bring down acceptance cost, you can actually do it with alternative technologies and do it very rapidly, and it works today, right.

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

Q

That's right.

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

Q

So, another piece of one of the things that you mentioned that you thought could help accelerate Visa's revenue growth was the growth in B2B like there is good opportunity there, clearly the B2B market is massive. I don't think that I ever heard you pretend to say we can address all of that right out of the gate, but there are things that you are doing. So, can you talk a little bit about that as an untapped opportunity? And I guess how does that play out over time? I mean I guess maybe help us [ph] shed eyes on that (10:13) opportunity first that you think you can address and then how does that start to play out?

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

A

Yeah. I think it's – what we've tried to do at Visa is not oversimplify things. It's very easy to talk about B2B as this massive $120 trillion operation...

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

Q

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Right, massive.

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

A

And that would be misleading people. First of all, I think there are a few things to understand about Visa B2B that's important to set the stage. Unlike B2C which is a very large homogenous market, B2B is not homogenous. Our business is a very large B2C market where every transaction looks very similar, whereas B2B is highly segmented. So, you really have to approach B2B segment-by-segment and each segment has very different needs. I mean the needs of a small business are very different than the needs of a very large multinational business. And the value we can add is very different. A payment being made, you know let's say an insurance payment being made to you as an individual is very different than a payment made by a big manufacturer to one of their suppliers. So, there is vast differences in B2B. We have played in B2B for a very long time. Nothing fundamentally has changed in the market, technologically there are more capabilities like Visa Direct now can enable a whole bunch of use cases that didn't exist before.

So, for example, the gig economy, you know you can now if you are an Uber driver use your debit credentials to get paid, that's a whole new use case. There is a whole range of those. If you are – you've seen those ads where, if you have an accident, you take a picture, you upload it and in a few minutes you know your debit card has been you know you see the insurance advance on your debit card.

So, there's a whole range of new use cases in B2B that are enabled by technologies like Visa Direct that we are actively pursuing right now. We've had the traditional B2B businesses, the commercial cards, the procurement cards, the single use cards, the virtual cards and so on.

So, you really have to go segment-by-segment and we're very focused on all these segments. We just acquired a company called Freedom last week. This is a company that provides a lot of enhanced reporting. That was a sole-supplier of ours and now we own them, so we can direct the business in ways that strengthen our B2B business. And then you get into more complicated B2B, where it's a bundle of services you're providing. So, let's say, I am a big multi-national operation and have a big accounts payable function. There are companies out there that will take the entire accounts payable function over. While the payment processing piece is a small piece of it it's not exclusive to Visa or MasterCard or one of us you pay everybody. Is that a business we want to be in and that's a different ballgame.

So, you really have to be careful when you look at B2B and we try not to throw out numbers on the size of the market and all that, because it depends on which segments do you really think are attractive to you and you can make money at.

And then the use are different, right. The fundamental value proposition is different in the – in the B2C space, the reason we add so much value is because we're allowing two people who don't know each other, and may never see each other again transact. In the B2B space, you're often transacting that people you already know and so the value proposition is different, the yields are different, the competition is different. So, yes, it's a very attractive opportunity, we're very focused on it, it is a long-term opportunity nothing fundamentally has changed in the last six months, and we'll keep plugging away at it.

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

Q

And I think that the point that you make about like how you facilitate a B2C or a consumer to consumer type transaction is really an important one and how that contrasts with B2B, and when we look at it and we talked

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about it we say, oh, the market could be much bigger but as you said the yields are going to look different because of..

Vasant M. Prabhu
Executive Vice President & Chief Financial Officer, Visa, Inc.
A

And there are some segments that we're advantaged in and some that are really very different businesses.

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

So you acquired Freedom for the reporting capabilities you said. Can you talk a little bit about Visa Direct and how that addresses some of those B2B opportunities?

Vasant M. Prabhu
Executive Vice President & Chief Financial Officer, Visa, Inc.
A

Yeah. We are very excited about Visa Direct, so fundamentally what Visa Direct is is an ability to do bank to bank account transfers. So it's not necessarily consumer to merchant but fundamentally using your debit credentials you can move money between bank accounts. And we now, by the end of this year and early next year will have enabled almost 2 billion debit cards to be capable to do Visa Direct. And what's phenomenal about it is that we can enable use cases that can use Visa Direct on a global basis which almost no one can – no alternatives can do. It's here today, it has a security and reliability that our network offers and it enables a whole bunch of use cases, some of which are B2B, some of which are government to consumer, G2C transfer payments and so on. Some of which are small b2b or B2b, like smaller lower value B2B types of payments and a whole range of use cases that typically were not things that we were able to do because we were directed strictly at, hey, let's call it a consumer to merchant transaction.

So Visa Direct now allows it's a fundamental change in how our network is used. So imagine a car that could only be on drive and never reverse. That's what our network was for its entire history so far, money only flowed one way, it flowed from you to a merchant. Now money flows both ways on Visa Direct, it can come into my account or out of my account.

And that's a phenomenal change when a network that only went one way allows you to go both ways and that's what Visa Direct is all about. It's growing very nicely, real volumes and the best part of it is its global, it's here today, it's available and it has all the things you would want to use it because it has security, reliability, speed and everything else that we offer.

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

So those are kind of the top line, some of the top line drivers we talked about continued growth in consumer and the push that you get there plus emerging opportunities on B2B. I wanted to move now to kind of profitability and what's happening in different aspects of that business, operating margins are approaching roughly 70%. Where do you see opportunities to increase investment to drive faster top line growth over the next few years and will that come at limiting margin expansion, how do we think about where we kind of top out and where it makes sense for you to instead of continuing to increase margins to increase investment.

Vasant M. Prabhu
Executive Vice President & Chief Financial Officer, Visa, Inc.
A

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So one of things you know we, we've said over and over again is that margins are not and have never been an objective, we never set a margin objective. In fact we explicitly do not set margin objectives nor should you want us to. Our job is to focus on two things, the first and by far the most important is to drive the digitalization of cash, which drives volumes. Growing volumes is the way to create value in this business both for our own stakeholders in the business, whether it's issuers or acquirers or consumers or merchants, but also for our shareholders because that is the fundamental value creator in this business is the growth of volumes. And then translating those volumes into revenues. So as long as we're doing a good job with that and can grow our volumes in the high single-digits and revenues in the high single-digits, that's what we are focused on.

The second thing then is at what level do we need to invest in this business to drive sustained long-term growth and to drive that conversion of cash to digital forms of payments. And every year, we want to be absolutely sure that we are investing as much as it makes sense to invest in the business. We fund all the important priorities which we strike a nice balance between not acting like a company that has lots of money to spend and therefore let's go spend it, but being very disciplined about it. And historically, that has worked out to expense growth in the mid-single-digits, largely because this is a business where scale is very important. A large chunk of our costs are fixed, and it's a technology based business and in many cases the costs of technology are dropping. So we – [ph] comment (19:08) this with these two variables in mind, and the margin is then an outcome. So as long as our revenues are growing in the high single-digits and at the appropriate level of investment, our expenses are in the mid-single-digits, there will be some increase in margins. But [indiscernible (19:22) as you know as the margins are higher, the incremental contribution doesn't drive them up at the same rate.

So we get to these margins because of how we drive these two decisions, but not as an objective in themselves. And that will change if one of these variables changes. If for some reason, volume growth are not sustainable or revenue growth is not sustainable at the levels we've been able to achieve or somehow the level of investment required is substantially greater than what was required in the past, neither of which we see in the foreseeable future.

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

Q

So I know there may be questions in the audience, if you have a microphone, I feel I think there's one right here. So let's start here in the middle and then we'll go to the side.

Q

Yeah. Well, thank you. To get back to the bigger drivers of your business over time, so I felt being a student of global economics, it appeared that we're kind of in a new time in the world, where corruption is under a lot more scrutiny and we're legitimizing a lot of economies at a faster rate than it potentially would have say take South Africa, India, Brazil, et cetera. Are there any proof points you could share that that is actually you can feel that within your numbers at this point and you can see that that's building or is that still two years or three years off in terms of very large regions starting to have a larger tailwind on your business? Thanks.

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

A

Yeah. So the question was about corruption and government's desires to get rid of corruption and what it means for our business. You're absolutely right, and if there's been a big change in the last 5 years or 10 years it is that governments have gotten interested in digitizing cash for the reasons you mentioned, transfer payments and the

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theft that happens and the money not getting to the right people and cash in general being where all the illegal and bad activity in an economy happens, whether it's tax evasion or criminal activity or...

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

Q

Or in Bitcoin, cash or Bitcoin.

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

A

That is one use case for Bitcoin, that is very viable, that's true. So, we are seeing more and more governments focus on this and it's clearly – I mean for example in India, one clear thing that came out of the demonetization whatever your views about whether right or wrong was that a lot of money came into the banking system and that money now is essentially in the visible economy and not in the black economy.

And that money now is part of what is benefiting all of us who process payments, so we are seeing lots of governments, Egypt, Chile, Mexico, you can name, almost every government now is deeply interested in understanding how to digitize cash and how we can help them and we are working closely with a lot of governments to explain to them how we can be helpful in making all this happen.

And this is clearly a long-term trend, it is not reversible. I believe that governments have fundamentally decided that this is where they want to go, but they're going to go there at different paces around the world. It's not going to happen overnight, there are lots of issues to resolve, there are even conflicts within societies because the elimination of corruption is not everybody's goal unfortunately, so there are frictions in the system from that standpoint too.

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

Q

So, the opening – we opened the door a little bit on international, so I want to ask a couple of quick follow-ups on that, first on Visa Europe. Where are we at or what – how far along the path are we or what inning in baseball parlances is Visa at in terms of taking opportunity to change pricing in Europe? And outside of pricing, what are the other sources of revenue synergies in Europe that Visa is hoping to achieve as technology platforms are combined and harmonized?

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

A

Well, as you know, I mean so far things have gone better than we expected at Visa Europe. We are running ahead of what we expected to be at from an accretion standpoint for a variety of reasons. The underlying economies have been strong, the cross-border business has been strong. We have been able to take some pricing. Our underwriting of the acquisitions was relatively conservative from the standpoint of pricing. We did Phase 1 of our cost reductions earlier on. We are now doing the important technology integration. We are now in the process of migrating clients from the Visa Europe platform to our global platform that is underway and will go on for a bit. We want to be very careful, we want to pace it right, do it carefully. Once that is done all the capabilities of the global Visa platform will be available in Europe. Some of them are available today, but this will allow the whole suite of capabilities, risk authentication as well as security will be substantially enhanced.

There will be a global backup for all these data centers. So there is phenomenal benefits that come from that and another set of reductions in costs, now that we don't have to run two platforms. In terms of further pricing our

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approach has been to take it one step at a time. We historically have never talked about pricing in any region of the world. We have talked about in Europe because we do get a lot of questions about it. Our approach has been we have a general idea of where we think on our pricing opportunities. We've taken the actions and then we evaluate them as we go along.

So we'll tell you more as we get to it. I would say what's left to do is certainly bringing all the capabilities we have to our European clients further cost reductions both in the technology integration, technology integration being the critical priority as we speak. And then we are very excited about all the opportunities in Europe. There are opportunities to grow credit in some parts of Europe. There are opportunities to clearly continue to displace cash in other parts of Europe. Europe is by no means a homogenous market; it is very, very different from region to region. All the way from Scandinavian countries that have done a phenomenal job of digitizing cash to Southern Europe or Eastern Europe where there is still huge opportunity. So we see just plenty of long-term opportunity in Europe, and those are some of the things we'll be focused on.

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

Q

So, Vasant, another international question, and we'll go to the questions from the audience. You know one of the questions we get a lot from investors is with Alipay and WeChat Pay trying to follow their consumers into international markets.

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

A

Yeah.

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

Q

How big of a risk is that to the cross border revenue opportunity for Visa from China outbound if you will. I mean how worried are you about local players like Alipay in China or Paytm in India are eating in the Visa's potential growth opportunity in those markets for cross-border?

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

A

Yeah. First of all, you have to separate China from other – from sort of the rest of the world. Clearly in China, some things have happened that were very unique to China, very unique to the circumstances in China. So the outbound business from China has always been one that China UnionPay was pursuing, as you know, and now Alipay and WeChat are pursuing, and we expect that to happen.

The outbound business from China is one part of our cross-border business, it is not a huge part of it. It has always been a business that the Chinese players have sought to bring on to their platforms. UnionPay has certainly went out and did some of that especially in the region right around China; and Alipay and WeChat are starting to do that, some of their business that Alipay and WeChat are getting is probably going to come from what UnionPay had. Like what has happened in China, and some would probably come from others. We think that's an inevitability, we knew that was likely to happen, and it's been underway for a while, this is not new.

In terms of Alipay and WeChat outside China, it's a different ballgame for them. They had a bunch of things going on in China that are not applicable outside China. Clearly, we should watch them closely. India is an interesting place to watch. How all these different models play out, certainly other parts of Southeast Asia are places where

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they are going to attempt to replicate what they did in China with some big differences. In many cases, they are recognized for what they are when they get into these markets i.e., they are a financial institution. Sometimes that aligns their interests with ours and it's not inconceivable that in some markets, we might in fact partner.

And in many cases, they don't have some of the things that allow them to build their businesses in the case of Alipay, you had the Alibaba franchise, in the case of WeChat, you had the app, you don't necessarily have those available once they move outside China. So these are all things we should be watching closely as they develop.

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

Q

Good. I think we had a question here.

Q

Vasant, can you just update us on your relationship with PayPal? You've had some issues in the past, are they all resolved? It seems like your partnering in the future, so just an update on your relationship with PayPal please?

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

A

No. It's – we're really happy with it. Look, our objectives here are very simple which is the transaction online through PayPal was full of friction before because PayPal was steering away from us, because it was hard to do dispute resolution. It's worked out very well for both of us. The online transaction through PayPal now if you want to use a Visa card, it's taken a lot of the friction away. Hopefully over time, that means people have a greater propensity to do transactions using Visa through PayPal, certainly that's a trend that we will monitor over time. We expanded the arrangement outside the U.S., so it's all headed in the right direction. We thought it was going to be a win-win for both sides and it's proving to be that.

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

Q

Great. Lightning question from Mr. [indiscernible] (29:22).

Q

Vasant, I had a question related to James' earlier question on the situation in China. In a number of ways, China is far more advanced in terms of mobile payments, are there lessons to be learned for Visa from what WeChat Pay or Alipay or TenPay have done?

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

A

Absolutely. There are clearly lessons to be learned. I think we have all watched what's happened in China. Clearly there is opportunities to apply some of those lessons especially in some emerging markets. We're seeing that play out in many markets, QR codes based payments systems. It's going to be different though. In India for example and in most countries people are going to a single national standard on QR code, it's not closed loop systems, it's open loop systems. So, there is no question that that model has applicability, but adapted in a different way because China had some unique aspects to it.

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James E. Faucette

Analyst, Morgan Stanley & Co. LLC

That's great. That's all the time we have. Vasant thank you very much for joining us today.

Vasant M. Prabhu

Executive Vice President & Chief Financial Officer, Visa, Inc.

Thank you.

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