Q3 2023 Earnings Call

Company Participants

- Devin Corr, Head of Investor Relations
- Michael Miebach, Chief Executive Officer
- Sachin Mehra, Chief Financial Officer

Other Participants

- Ashwin Shirvaikar
- Bob Napoli
- Bryan Keane
- Craig Maurer
- Dan Dolev
- Darrin Peller
- David Togut
- Harshita Rawat
- Jason Kupferberg
- Jeff Cantwell
- Ramsey El-Assal
- Sanjay Sakhrani
- Tien-Tsin Huang
- Timothy Chiodo
- Will Nance

Presentation

Operator

Good morning. My name is Audra, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mastercard Incorporated Q3 2023 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) Mr.Devin Corr, Head of Investor Relations, you may begin your conference.

Devin Corr {BIO 23558629 <GO>}

Thank you, Audra. Good morning, everyone, and thank you for joining us for our third quarter 2023 earnings call. With me today are Michael Miebach, our Chief Executive Officer; and Sachin Mehra, our Chief Financial Officer. Following comments from Michael and Sachin, the operator will announce your opportunity to get into the queue for the Q&A session. It is only then that the queue will open for questions.

You can access our earnings release, supplemental performance data, and the slide deck that accompanied this call in the Investor Relations section of our website, mastercard.com. Additionally, the release was furnished with the SEC earlier this morning. Our comments today regarding our financial results will be on a non-GAAP, currency-neutral basis unless otherwise noted. Both the release and the slide deck include reconciliations of non-GAAP measures to GAAP-reported amounts.

Finally, as set forth in more detail in our earnings release, I'd like to remind everyone that today's call will include forward-looking statements regarding Mastercard's future performance. Actual performance could differ materially from these forward-looking statements. Information about the factors that could affect future performance are summarized at the end of our earnings release and in our recent SEC filings. A replay of this call will be posted on our website for 30 days.

With that, I will now turn the call over to our Chief Executive Officer, Michael Miebach.

Michael Miebach {BIO 16087573 <GO>}

Thank you, Devin. Good morning from New York, everyone. Let me start by acknowledging the recent terror attacks in Israel and the resulting war with Hamas and the growing humanitarian crisis in Gaza. We're deeply saddened by the suffering and the loss. Our focus is on the well-being of our people, those who have been directly impacted, and those in our teams around the world who are dealing with this terrible situation. We will continue to give them support while contributing to relief efforts. We will monitor the situation closely so we can take action as required.

Turning to our results. Our quarter three results demonstrate the strong fundamentals of our business, our diversified model, and the continued resilience in consumer spending. Quarter three net revenues were up 11% and operating income was up 13%, both versus a year ago on a non-GAAP, currency neutral basis, excluding special items.

On a macroeconomic front, there are a few factors we focus on. First, the labor market remained strong, which is a key driver of consumer spending. However, we continue to monitor aspects such as credit availability and savings behaviors. Second, although inflation levels have moderated, they remain elevated. As central banks continue to actively manage monetary policy, we expect the impacts to vary across countries and sectors. Also, geopolitical uncertainty remains a concern, further underscored by the recent events in the Middle East. We're monitoring these moving pieces and stand ready to manage the business accordingly.

Looking at our switch trends this quarter, domestic volume growth remains healthy with some moderation in spend in select international markets. Cross-border travel remains strong at 155% of 2019 levels in the third quarter. And cross-border card present ex-travel continues to hold up well at 209% of 2019 levels in the third quarter. And this is cross-border card not present ex-travel.

So overall, consumer spending remains resilient and we remain focused on executing against our strategic priorities. We see substantial runway for growth through the long-term potential in person-to-merchant payments, the sizable opportunity to address new payment flows, our diverse suite of fast-growing service capabilities, and our investments in areas of future growth like open banking and digital identity.

Let's explore these in more detail. Starting with person-to-merchant payments where we see a sizable long-term growth opportunity. We're winning deals with a diverse set of partners and investing in technology to further drive the shift to electronic forms of payment and capture new ways to pay. The third quarter, our deal momentum across the globe continued.

In the U.S., we're happy to announce that Webster Bank, a leading commercial bank in the Northeast, has chosen Mastercard as their exclusive payment network. They selected us because of our marketing assets, safety and security tools, and commitment to small business. This builds up on recent wins in the U.S. like the Citizens Debit Portfolio Flip with the transition on track for 2024. These two wins are clear examples of the value we deliver through our partnerships and the reasons banks are willing to move their debit business to Mastercard.

Further, we have partnered with Citi's wealth business to launch their ultra high net worth credit proposition, targeting their private bank clients in Singapore and Hong Kong. And in East Africa, we signed a long-term deal with Equity Bank Group that significantly increases our share across the six markets where they have presence.

On the co-brand front, we joined Barclays to launch Xbox, first credit card in the United States. Building off our long-standing relationship with Microsoft, this product is an example of how we're tapping into the fast-growing gaming space. And of course, we continue to strengthen our travel-focused programs, renewing our Frontier Airlines program issued by Barclays, as well as the Turkish Airlines program with Garanti BBVA.

Winning deals positions us well to capture PCE and secular growth. There's a sizable opportunity across volumes and transactions, and we benefit from both. We're bringing together innovation, technology, the experience, and trust that consumers want and expect in their daily lives. And that starts with our best-in-class digital solutions, such as contactless and tokenization.

Contactless now represents 63% of our in-person our switch purchase transactions, and the convenience and security of our capabilities are helping us to further penetrate verticals like transit. By converting transit to open loop, we gain access to more low-ticket, high-frequency transactions, both at the station and the surrounding merchants. In the last quarter alone, we launched Open-Loop programs with two of the largest transit systems in North America, Toronto and Philadelphia. We're now live with over 25 agencies in the U.S. and Canada. This year in the Netherlands, we supported the launch of a nationwide contactless transit payment system. And in Pakistan, we're helping to digitize daily commutes in Karachi with issuance over 1 million prepaid Open-Loop cards.

On tokenization, it has been 10 years since we first introduced the token standard to the industry. Today, it is foundational to the network and it's performing exceptionally well. The number of tokenized transactions has more than doubled over the past two years. We just processed over 3 billion tokenized transactions in one month. And this functionality is extending to new places to pay.

For example, Mercedes-Benz customers in Germany can now pay for fuel directly from their vehicle using only their fingerprint. And Hyundai Motor America is enabling in-vehicle payments for parking with additional features and EV use cases to be enabled in the future.

Digital solutions are also key to migrating Maestro to Debit Mastercard. This conversion drives a better cardholder experience, including in many cases the ability to shop online and across borders, which leads to incremental card spend. And prior to full transition, we offer a virtual companion card to the current Maestro cards for immediate online use.

In Europe, we're in the process of sunsetting new issuance of Maestro, and we will continue to work with our issuers on the migration of well over 100 million cards over time. A lot happening in P2M for sure.

On to the second vector for growth, new payment flows. There are substantial untapped flows across commercial payments and the disbursements and remittance space. In commercial, we continue to see strong growth. We're expanding our market-leading virtual card capabilities into new use cases. In the U.S. and Canada, our mobile payment solution is now live with BMO and tech partner, Extend, bringing our virtual card capabilities to contactless business payments.

We also continue to expand our reach to corporates by partnering with Oracle to embed Mastercard virtual card capabilities into their Fusion Cloud ERP to enable supplier invoice payments and corporate purchases. And we are integrating our commercial payment and open banking capabilities into SAP Fioneer platforms to deliver an embedded payment and lending experience.

There remains a significant opportunity to conversion check to commercial card products. We're signing deals across the globe to do just that. We're excited to announce that we have agreed a long-term deal with Citibank to forge a global commercial card partnership covering more than 60 markets. The deal extends our leadership position with Citibank and reinforces our efforts to modernize and grow B2B payment flows. We also signed our first ever commercial contract with Axis Bank in India and a commercial deal with the biggest investment bank in Latin America, BTG Pactual.

Now, let's focus on disbursements and remittances. With access to more than 95% of the world's bank population, our reach spans more than 180 countries and more than 150 currencies, and we are seeing strong growth. The third quarter transactions were up more than 30% on a year-over-year basis.

To continue growing in this space, we're expanding into new use cases and geographies. A great example is our partnership with Remitly, one of the fastest growing digital remittance platforms with over 5 million active users. Remitly will leverage our disbursement and remittance solutions to help make international payments faster, easier, and more secure. We're also expanding our collaboration with Paysend in the UK to enhance cross-border payments for SMEs.

Now our value-add services and solutions are another important driver for our growth. Collectively, this suite of capabilities is fast-growing and provides a diversified revenue stream. We have invested thoughtfully to develop services focused on supporting our customers in areas of growing need. Cybersecurity threats are rising, a trend that will unfortunately persist. And there's an increasing demand for actionable insights and more personalized experiences.

Our services, bolstered by our data-driven intelligence, can help customers reduce fraud, grow their portfolios, and better engage with their end-customers. Take our cyber solutions, which protect consumers and the payments ecosystem more broadly. One example is SafetyNet, which in the past 12 months has prevented more than $20 billion in fraud. This is just one of our many fraud solutions that we're deploying to deliver more value and support continued growth.

AI also continues to play a critical role powering our products and fueling our network intelligence. We're scaling our AI-powered transaction fraud monitoring solution, which delivers real-time predictive scores based on a unique blend of customer and network level insights. This powerful solution gives our customers the ability to take preventive action before the transaction is authorized.

This quarter alone, we signed agreements with Argentina, Saudi Arabia, and Nigeria with financial institutions and fintechs who will benefit from early fraud detection and with merchants who will experience less friction and higher approval rates. In the end, this all makes for a better consumer experience.

We're also using our services, combining our data and expertise to help clients optimize and do more with their portfolios. This drives both direct services revenue and incremental payments revenue.

Our consulting, marketing services, and targeting analytics help clients design and execute portfolio migrations, drive incremental card acquisition, and stimulate spend. For example, in Spain, we are working with Financiera El Corte Ingles to boost the migration of closed-loop clients to our new open-loop co-badge proposition. And we're working with Saudi National Bank to enable growth in their credit portfolio by increasing penetration from their debit base.

So the headline for me is the power of our strategy to drive payment network and service revenue for Mastercard. Service improved the performance of a client's portfolio, leading to incremental payment flows, which lead to more opportunities to use our services, and so on, and so on. It's a virtuous circle. We also had success in expanding our customer base and services through best-in-class personalization and our leading test-and-learn analytics capabilities. Don't just take our word for it.

Gartner recognized the superior value proposition of dynamic yields, personalization activities, and selected it as the leader in its 2023 Gartner Magic Quadrant for the third year in a row. That's why luxury brands like Saks Fifth Avenue work with us to create hyper-personalized experiences for their e-commerce customer.

This quarter, we extended our partnership with the merchant Aldi in both the U.S. and Australia to continue to leverage our test-and-learn platform to optimize category reviews, store hours, and marketing spend. And we're working with Dunkin' International to enhance their foundational data analytics capabilities to improve operational efficiencies.

Our best-in-class solutions address the unique needs of a diverse set of customers, giving us ample opportunity to continue to grow across our value-added services and solutions.

We have a strong foundation for growth in P2M, as discussed, new flows and services, and we are also embracing new opportunities for future growth. As digital adoption continues to rise, open banking remains a key opportunity. We have a powerful set of assets with connectivity to over 95% of deposit accounts in the U.S. and 3,000 banks across Europe. We're engaged with a broad set of partners who are increasingly interested in the scale and potential of the open banking solutions we bring. This includes the account-to-account bill payments use case.

Our banking -- OpenBank solutions enhance existing ACH flows by providing a simple and secure experience, allowing consumers to seamlessly share data with trusted parties. Previously announced partnership with J.P. Morgan Payments, Pay-by-bank is now live, and Verizon plans to pilot this offering with their U.S. customers in the coming months. In addition to this, we're now collaborating with WorldPay to enable consumers to pay bills directly from their bank account. Our progress here continues.

So in summary, our third quarter results reflect the strong fundamentals of our business and the continued resilience in consumer spending, their substantial runway supported by opportunities to digitize person-to-merchant payments across both the dollar volume of flows and the number of transactions, and opportunities to address new payment flows and extend our diverse suite of services, all while we continue to invest in future areas for growth. When you put it all together, our diversified business is well-positioned for strong growth for years to come.

Sachin, over to you.

Sachin Mehra {BIO 15311008 <GO>}

Thanks, Michael. Now turn to Page 3, which shows our financial performance for the quarter on a currency-neutral basis, excluding, where applicable, special items and the impact of gains and losses on our equity investments. Net revenue was up 11%, reflecting resilient domestic consumer spending and strong cross-border volume growth, as well as the continued growth in our value-added services and solutions.

Operating expenses increased 9%, including a 1 ppt increase from acquisitions. And operating income was up 13%, including a minimal impact from acquisitions. Net income and EPS increased 21% and 24%, respectively, both reflecting the strong operating income growth, as well as a net tax benefit, which was primarily discrete due to U.S. tax guidance released in the current period. EPS was $3.39, which includes a $0.09 contribution from share repurchases. During the quarter, we repurchased $1.9 billion worth of stock and an additional $475 million through October 23, 2023.

So let's turn to Page 4, where you can see the operational metrics for the third quarter. Worldwide gross dollar volume, or GDV, increased by 11% year-over-year on a local currency basis. In the U.S., GDV increased by 5%, with credit growth of 7% and debit growth of 4%. Outside of the U.S., volume increased 13%, with credit growth of 13% and debit growth of 14%.

Sequentially, the debit growth rate was primarily impacted by the lapping of the NatWest portfolio migration in the UK. Overall, cross-border volume increased 21% globally for the quarter on a local currency basis, reflecting continued strong growth in both travel and non-travel-related cross-border spending. While this is sequentially lower versus Q2, this is due to tougher comps as we lapped the cross-border travel recovery from last year. When you look at the trend versus 2019, as Michael said, cross-border travel remained strong at 155% of 2019 levels in Q3, and cross-border card-not-present ex travel continues to hold up well.

Turning now to Page 5, switch transactions grew 15% year-over-year in Q3. Both card-present and card-not-present growth rates remain strong. We also continue to increase the percentage of transactions we switch. This is strategically important for us, as it presents a revenue growth opportunity in both payments and services. An example of this is in Japan, where we began switching domestic transactions last September.

In Q3 2023, we switched over 65% of our total transactions worldwide. For historical context, this figure was approximately 55% in 2018. In addition, card growth was 7%. Globally, there are 3.3 billion Mastercard and Maestro-branded cards issued. Turning to Slide 6 for a look into our net revenues for the third quarter discussed on a currency-neutral basis. Payment network net revenue increased 10%, primarily driven by domestic and cross-border transaction and volume growth, and also includes growth and rebates and incentives. Value-added services and solutions net revenue increased 14% relative to a strong Q3 a year ago.

So let me give you a little bit of color. Our cyber intelligence solutions continued to grow at a healthy pace driven by our underlying key drivers and demand for our fraud and security solutions. And we continue to see strong demand for our consulting and marketing services, as well as our loyalty solutions, which is partially tempered by their solutions.

Now let's turn to Page 7 to discuss key metrics related to the payment network, again, described on a currency-neutral basis unless otherwise noted. Looking quickly at each metric, domestic assessments were up 10%, while worldwide GDV grew 11%. The difference is primarily driven by mix. Cross-border assessments increased 26% while cross-border volumes increased 21%. The 5 ppt difference is primarily due to mix.

Transaction processing assessments were up 11% while switch transactions grew 15%. The 4 ppt difference is primarily due to lower revenues related to FX volatility versus the prior year. Our network assessments related to licensing, implementation, and other franchise fees were $229 million this quarter. As a reminder, these other network assessments may fluctuate from period-to-period.

Moving on to Page 8. You can see that on a non-GAAP currency-neutral basis, excluding special items, total adjusted operating expenses increased 9%, including a 1 ppt impact from acquisitions. This increase was primarily due to increased spending on personnel to support the continued execution of our strategic initiatives.

Now turning to Page 9, let me comment on the operating metric trends in the third quarter and through the first three weeks of October. Starting with switched volume growth year-over-year, we lapped the NatWest migration early in the quarter and the commencement of switching in Japan late in the quarter. These factors are the primary drivers of sequential declines in both Q3 and into October.

One point on the U.S., the sequential drop in October primarily relates to the timing of certain social security payments this year versus last. Switched transactions follow similar patterns.

Looking at cross-border, cross-border travel growth is being impacted by tougher comps as we continue to lap the recovery of travel. When compared to the 2019 index, cross-border travel metrics remain strong. Cross-border card-not-present ex-travel continues to show strength. Just for your information, we have included all the data points from the schedule, excluding activity from Russian-issued cards from current and prior periods in the appendix.

Turning to Page 10, I wanted to share our thoughts on Q4. So let me start by saying consumer spending remains resilient and that our diversified business model continues to position us well for the many opportunities ahead. We are closely monitoring the elevated macro and geopolitical concerns and stand ready to adjust expenses should circumstances warrant.

Consumer spending patterns continue to normalize post-pandemic, while pockets of opportunity remain for further recovery of cross-border travel, notably into and out of China. This will take some time as these corridors continue to face a variety of constraints. Having said this, our base case scenario continues to assume consumer spending remains resilient, buoyed by strong labor markets, and reflects recent spending dynamics. With respect to the fourth quarter, we expect year-over-year net revenue to grow at the lower end of a low double-digits rate on a currency-neutral basis, excluding acquisitions.

Acquisitions are expected to have a minimal impact to this growth. Due to the recent strengthening of the U.S. dollar in Q4, foreign exchange is now expected to be a tailwind of approximately 0 ppt to 1 ppt for the quarter, as compared to the 3 ppt to 4 ppt benefit we had previously expected. This follows the impact we saw in the third quarter, where the stronger dollar led to a foreign exchange benefit of 2 ppt to revenue, down from our initial expectations of a 3 ppt benefit.

From an operating expense standpoint, we expect Q4 operating expenses to grow at a high-single-digit rate versus a year ago on a currency-neutral basis, excluding acquisitions and special items. Acquisitions are forecast to add about 1 ppt to this growth, and foreign exchange is expected to be a headwind of between 0 ppt to 1 ppt for the quarter.

Other items to keep in mind. On the other income and expense line, we forecast an expense of approximately $85 million for Q4. This excludes gains and losses on our equity investments, which are excluded from our non-GAAP metrics. Finally, we expect a tax rate of approximately 18% to 19% in Q4, based on the current geographic mix of our business.

And with that, I will turn the call back over to Devin.

Devin Corr {BIO 23558629 <GO>}

Thank you, Sachin. Thank you, Michael. Audra, you can now open the call up for questions.

Questions And Answers

Operator

(Question And Answer)

Thank you. (Operator Instructions) We'll take our first question from Sanjay Sakhrani at KBW.

Q - Sanjay Sakhrani {BIO 7390132 <GO>}

Thanks. Good morning. Sachin, when we look at that fourth quarter revenue deceleration, I think this is what the outlook implies, how much of it is like macro versus timing of incentives or something like that? I'm just curious, what factors are sort of driving that and how we should think about that outlook if there's still moderating trends going forward? Thanks.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure, Sanjay. So a couple of thoughts. One, in the fourth quarter, you remember last year, we continued to experience elevated levels of FX volatility in the fourth quarter of last year. And those FX volatility levels have certainly moderated by a meaningful extent. You saw some of that come through in Q3. There's more that we would expect at current volatility levels in Q4. So that's certainly baked into our thinking.

And then to your point around rebates and incentives, look, we continue to compete in this market and we have a strong pipeline of deals. We continue to win, as you've seen in the nature of the various announcements we've put out, and I would say our planning, for planning purposes, we're continuing to execute on the strong pipeline. You would expect that contra sequentially would be up as a percentage of our assessment revenue in the fourth quarter, not too different than what you would see in any other year.

We typically have higher contra levels in the fourth quarter when you look at them as a percentage of our assessment revenue. So, really, that's what's there. And to your specific point around macro, it's like I said, our base case assumes, a resilient consumer, and that's very much what we're assuming going forward as well. There are always puts and takes depending on markets in question, but broadly speaking, we continue to see a strong consumer.

Q - Sanjay Sakhrani {BIO 7390132 <GO>}

Thank you.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure.

Operator

We'll go next to Tien-tsin Huang at J.P. Morgan.

Q - Tien-Tsin Huang {BIO 6065319 <GO>}

Hi, thanks. Good morning to everyone. Just on the Europe front, I noted that it did slow a little bit, the 4 points, I think, sequentially year-on-year. Is that just a NatWest comp out? Is there anything else to call out? I'm curious if you saw any change in or interesting performance country by country in Europe? Thanks.

A - Sachin Mehra {BIO 15311008 <GO>}

Yeah. Sure, Tien-Tsin. So couple of thoughts. First, it's primarily the lapping effect of NatWest. So let's start there. There are always going to be puts and takes by country. I would say that, Michael talked a little bit about in select international markets, we're seeing some level of moderation. I would say in Europe, you're seeing that in the UK. But largely, if you see the decel which you're talking about, that's largely driven by the lapping of our NatWest win last year.

Q - Tien-Tsin Huang {BIO 6065319 <GO>}

Thanks for clarifying. Thank you.

Operator

We'll go next to Harshita Rawat at Bernstein.

Q - Harshita Rawat {BIO 18652811 <GO>}

Hi. Good morning. I want to ask about regulation. There's been some unrelated activity recently with the Fed proposing new debit interchange caps, REG-II, implementations for card non-present and the Credit Card Competition Bill. So, Michael, taking a step back, how are you thinking about the regulatory environment in the U.S. and abroad? Thank you.

A - Michael Miebach {BIO 16087573 <GO>}

Thank you, Harshita. Thank you for directing that straight to me, after a few questions on trends. But there is certainly a lot going on, so that's for sure true. You can -- it's a lot of activity, and they have been overlapping, REG-II, CCCA, the Fed on debit. So all this is related in a way, but it's also not related in a way. And I think this is important for us to take them one by one. And without any particular order, let me start with CCCA, which has been a topic on this call for a little while. This topic is garnering a lot of momentum across the -- our industry and industry participants. We are seeing a more united voice across banks and across merchants to address this point.

Senators Durbin and Marshall have been very active over the last -- since the last quarter since we last walked to attach this particular legislation proposal to other proposals and get a vote. They were not successful, and I think we actively used the time and productively used the time to bring across that this is not good for consumers. It is not good for small business. It is not good for merchants, particularly those who are driving large reward programs. So for all those reasons, we think this is going to -- is a misguided proposal, a misguided legislation and we'll see where it goes going forward. But I've not been more optimistic on the industry pulling together to making those arguments understood than at this point.

So this is CCCA. We're closely engaged on that. Now on REG-II. So we were in compliance with that. Have we seen any particular outcome? I think it was a question on last call. Do you see this as an opportunity or as a risk? At this point, neither. What I can tell you is we will compete. We have invested billions over the years in the security of our network proposition, and we think security is at the center of this whole debate. Can the merchant take away decisions from a consumer here and route this to the least cost and possibly the least secure network? Well, that is what we want to point out that that shouldn't be the case. We're leaning in on that. We haven't seen it yet at this point. So for us to just monitor and see what happens, we'll surely talk about it again next quarter.

The Fed debit pricing, the piece that was put out yesterday is going into a consulting period. Here again, the same kind of momentum across the industry, across the American Bankers Association, the Electronic Payments Council, put out a letter to the Fed on Friday night along with seven other trades, if I recall correctly, arguing that this -- that price caps are generally driving market distortions, this is not a good thing, it's not a good thing for the consumer, yet again not a good thing for merchants -- for the merchants who run reward programs and so forth. So we'll have to see where it goes.

It is important, though, to point out that interchange is a balancing mechanism for the industry, it does not directly affect our P&L. So, those are important things to keep in mind.

For all of those, we see ourselves as an industry custodian to make sure that the arguments around safety and security and consumer choice are fully understood by all stakeholders.

Q - Harshita Rawat {BIO 18652811 <GO>}

Great. Thank you very much.

Operator

We'll go next to Craig Maurer, FT Partners.

Q - Craig Maurer {BIO 4162139 <GO>}

Hi. Thanks for taking the question. Actually, two. One, considering what we're seeing in the U.S. with deterioration in certain, should I say credit quality buckets and so on and so forth, I'm curious if you could discuss how your spend in the U.S. is broken down between sort of the top 1% and the rest versus historical levels, just might get to help us understand how insulated spend is to the specific credit issues we might be seeing over the next six months.

And secondly, we've seen some pretty strong rhetoric out of Asia regarding moving away from the global networks to actions taken around Russia and other places. I was wondering if you could comment on how discussions with those markets might have changed in recent times? Thanks.

A - Sachin Mehra {BIO 15311008 <GO>}

Hey, Craig. It's Sachin. I'll take your first question on the spending trends in the U.S. and particularly in light of what you're talking about on the deterioration of credit quality. The headline for you is the following. Our portfolio in the U.S. is actually a pretty well-diversified portfolio, across all spectrums of the consumer base.

If you look at our company 10 years ago, I would argue, it was a company which was more kind of weighted towards our credit portfolio. We have got a better mix right now of credit and debit across the spectrum of consumers. And diversification has always been our friend, whether it's around products, whether it's around geographical markets, that's kind of the way we've kind of tried to drive the strategy of the business.

I would tell you, I mean, if you at the composition of the issuers in the U.S., right, so we have a decent amount of co-grant portfolios, which cater to the affluent, and fully from a credit quality standpoint, they stand to actually hold up pretty well, even in down markets. The other piece I tell you is that, we like the fact that we have been recently investing in winning debit portfolios. We've talked about how we won citizens. We talked about -- Michael just talked about how we won Webster. These are important portfolios because, as you know, in up and down cycles, right, what happens with a diversified portfolio is in down cycles, debit tends to be in favor because of the spend going towards these non-discretionary categories of spend. So, the headline I tell you is, pretty well diversified across product and across the spectrum of consumers in the U.S.

A - Michael Miebach {BIO 16087573 <GO>}

And as we were saying earlier, we're monitoring credit availability. Credit availability is not an issue as far as we can see, and at points, it's beyond historic level. It's below historic level. So, that's something that is part of our continuing efforts to understand where the dynamics are going.

Now, on Asia, you anchored the question on their strong rhetoric from Asia. I would probably word this differently and say we're not seeing that. We're seeing this is an argument in a broader conversation around where value is coming from, the value of globalization and global connectivity. On the other hand, things like sanctions play into this. It's a very complex mix. And across the world, not just in Asia, there is a conversation around weighing all of that off. So it's important for you to understand that we have been partnering with countries around the world for years.

Just take Europe to start with. Early on, we talked about Maestro and Debit MasterCard. We're partnering with a whole range of local payment systems for years. And there are no particular concerns around that. The same is in many other parts of the world. Where this is going and going forward, we'll have yet to see, but it is understood that as part of a globally connected economy and a world where some de-risking plays into that, trusted cross-border data flows matter, people still want to travel, and all of that makes us an important player. Also keep in mind that our capabilities across network level, trusted solutions, cybersecurity solutions gets us a seat at the table.

We're seen as a technology company and a global technology company, not necessarily as a U.S. payment brand when we have those conversations, because we help across. We enable local payment solutions through those services. So I'm not overly worried about this, but it's an active dialogue where we are seeing some really good things coming out of that. Think about some of the advancements in financial inclusion when local governments set up systems that reach consumers that haven't been reached before. That lifts everybody's vote, and that is good for the overall payments industry. So it is a broad topic.

We've been engaging through the U.S. government, through other governments, multilateral organizations, and I personally spend quite a bit of time on that topic to ensure that we don't lose the benefit of a globally connected economy.

Q - Craig Maurer {BIO 4162139 <GO>}

Thank you.

Operator

We'll move next to Will Nance at Goldman Sachs.

Q - Will Nance {BIO 20732798 <GO>}

Hey, guys. I appreciate you taking the question. I wanted to ask about some of the trends in value-added services. It sounds like the commentary this quarter was similar to last quarter, kind of a tale of two Ss, relatively strong growth in services and maybe a little bit of drag from solutions. I was just wondering if you could talk on the drag in solutions, a little bit of color on what's driving that. And maybe for the outlook, how long should you -- should we kind of expect that drag to continue and what's sort of the outlook for the two buckets?

A - Sachin Mehra {BIO 15311008 <GO>}

Sure, Will. So a couple of thoughts first. Like we mentioned in my prepared remarks, value-added services and solutions, net revenue increased 14% this quarter. I will kind of emphasize that our cyber intelligence solutions continue to grow at a healthy pace. This obviously is driven by underlying drivers as well as demand for our various solutions we offer. And we're seeing similar trends in terms of strong demand for our Consulting and Marketing services and Loyalty solutions.

To your point about the tempering effect of other solutions, that certainly is having a tempering effect. And when we have -- what we have in other solutions is the relative growth rates from real-time payments, from what's going on from a bill payment standpoint. It's things of that nature, which are actually growing at a slower pace, which is candidly, I mean, something which we should expect.

The reality is we always talked about services in the past. We haven't talked about value-added services and solutions. Now we're talking about value-added services and solutions, which is where you're seeing that tempering effect come through. I think if it's helpful, one of the things which I want to actually also share with you is that this overall growth rate can be impacted quarter-to-quarter by transaction growth, by comps, and by timing. And just as a reference point, when including -- but sorry, when excluding other solutions where -- which have the tempering effect, our value-added services have grown at 19% year-over-year on a year-to-date basis, excluding Russia.

So I think what I'm kind of trying to share with you is there is this tempering effect on other solutions. You should expect that tempering effect to continue. All of that being said, there is the overall strength we see in our C&I and D&S side, which we're actually very positive of. We're seeing good demand in that space.

Q - Will Nance {BIO 20732798 <GO>}

Got it. Thank you.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure.

Operator

We'll take our next question from David Togut at Evercore ISI.

Q - David Togut {BIO 1496355 <GO>}

Thank you very much. Given some of the tempering growth that you've highlighted, especially in VAS, how are you thinking about flexing expenses over the next 6 to 12 months? Where do you have a fair amount of discretion? And what are some of the areas, particularly like R&D, which would be sacrosanct?

A - Michael Miebach {BIO 16087573 <GO>}

Right. So, what Sachin said, he wasn't really talking about the tempering in VAS. He was talking about tempering in the other solutions. So I just want to kind of get that straight out. I think there is potentially a little bit of confusion here with our revenue disaggregation and the definitions here. We've talked about services in a particular way for years, and now we have a slightly different definition, as you know, which we shared with you. So, I just want to put that out there first.

To your question. So, we continue to expect strong growth in value-added services and solutions, D&S and C&I, as we said. As far as expenses go, I said it at the beginning, looking at macro, looking at everything that's going on around us, and we have demonstrated this through COVID, we have demonstrated it through Russia, and we will continue to demonstrate as we have a whole range of levers in a not particularly capital-heavy business to adjust our expenses.

You've seen us managing for positive bottom-line and top-line growth on a year-over-year basis. We're not managing this quarter-by-quarter, but that is always something that we keep in mind. So our financial discipline will continue here. We have no reason to change that. It's working well, and that is the disciplined way to do this. Thank you.

A - Sachin Mehra {BIO 15311008 <GO>}

Yeah. And David, I'll just add, right, just as Michael said, I think our philosophy from an operations standpoint is to continue to deliver positive operating leverage over the long-term. We will do that in a disciplined manner to continue to drive short, medium, and long-term growth, and we will invest prudently. And we'll obviously keep an eye on what's going on the top-line and kind of moderate on expenses as appropriate, as we've done historically. So I just want to reiterate exactly what Michael said better.

Q - David Togut {BIO 1496355 <GO>}

Yeah. (Multiple Speakers)

A - Michael Miebach {BIO 16087573 <GO>}

Thank you.

Operator

Next to Bryan Keane at Deutsche Bank.

Q - Bryan Keane {BIO 1889860 <GO>}

Hi, good morning. Sachin, I just wanted to ask about more chunkier portfolios and the timing of it. Obviously, NatWest anniversary, that might have surprised some people on the comps, but it's just an anniversary of that. So just thinking about Citizens or Webster or others, the timing on when they come on and any others out there.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure, Bryan. So on Citizens, the portfolio transition is on track for 2024. You should expect that that will take place over a period of time as opposed to a flip the switch kind of environment. Webster we just announced, which we're super excited about, right? And the portfolio transition will also begin in 2024 and will take place over a period of time. Santander is done. NatWest I already spoke about. The other one actually, which I kind of point out is Deutsche Bank, right? And there we had talked about conversion of 10 million cards. That conversion has started. There's a combination of debit and credit, will happen over an extended period of time. Again, it's not a flip the switch kind of scenario.

And the last one I'd mention is around UniCredit, which is something which will happen over multiple years. So this is not -- and when I say multiple years, I literally mean you'll start in 2024 and this will work its way through over a few years. So that's what I can share with you in terms of at least the chunky ones. Obviously, there are a bunch of other portfolios which we win all the time, but these are the bigger ones.

Q - Bryan Keane {BIO 1889860 <GO>}

Thank you.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure.

Operator

Our next question comes from Tim Chiodo at UBS.

Q - Timothy Chiodo {BIO 16128908 <GO>}

Great. Thank you for taking the question. I just wanted to take this as an opportunity to revisit some of the mechanics around rebates and incentives. If you could just provide a recap on the portions of rebates and incentives that are volume and performance-based, some of the portions that are maybe more fixed, and then the portions that are more cumulative over the course of a contract. I think that would be appreciated by all. Thank you.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure. So, first, the reason we do rebates and incentives is to drive volume. I just want to be clear, that's kind of what drives, what we're trying to do, which is to win preference, which allows us to generate revenue from the payment stream, as well as to deliver services to drive our net revenue yield. So, that's kind of the headline.

Your specific question around rebates and incentives, right? It's a combination, typically, of fixed and variable. It depends on a deal-by-deal basis. If it's a fixed incentive, the fixed incentive is typically amortized over the life of the deal. Variable incentives are variable in nature. They vary with the volume which are coming through, and they are timed with how the volume rolls on. So, that's kind at the highest level. The other piece I kind of share with you is rebates and incentives are typically more indexed towards domestic volumes and less indexed towards cross-border. So, those are the salient pieces I've mentioned to you on rebates and incentives.

Q - Timothy Chiodo {BIO 16128908 <GO>}

Great. We appreciate it. Thank you.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure.

Operator

We'll go next to Dan Dolev at Mizuho.

Q - Dan Dolev {BIO 16010277 <GO>}

Hey, thanks. Michael, I just want to give you a compliment first because this is close to my heart and I appreciate you mentioning the terror attack on Israel. I think your competitor made it more like of a politically correct comment on their call. So, I really appreciate it.

And then to my question, a key European merchant acquirer called out like a big negative trend in Germany and as you know the whole market trended down. Can you make some specific comments of stuff that you're seeing? Because it seems like trends are actually pretty solid and pretty resilient. So, there's quite a bit of confusion in the market. We would appreciate some comments on the European macro trend. Thank you.

A - Michael Miebach {BIO 16087573 <GO>}

Thanks, Dan. As you can appreciate, I keep a close eye on the German market very specifically, and we're not seeing that, where consumer spending remains pretty steady in Germany and generally in Europe. Sachin talked a little bit about one UK might have a couple of -- a little bit of moderation here and there, but overall we're not seeing that. So what we see, on the other hand, as you know is strong growth for us in Europe on all of the migrations, on our debit Maestro migrations and so forth. So Europe's been a bright star, continues to be for us, so we don't quite relate to what others are reporting.

Q - Dan Dolev {BIO 16010277 <GO>}

Thank you, I appreciate it.

Operator

We'll go next to Darrin Peller at Wolf Research.

Q - Darrin Peller {BIO 16385359 <GO>}

Thanks, guys. I just wanted to follow-up a little bit more on the incentives and rebates. But first, just Michael, the number of portfolios that you guys are winning on the different parts of the world, really. But just talk a little bit about the competitive landscape with whether it's UniCredit or now Citizens or others that you keep talking about, if anything's changed. And that kind of dovetails into incentives and rebates because the growth, I mean, you're about 500, 600 basis points faster than gross revenues you're seeing on it. Maybe that part's more for Sachin.

And just it offsets some of the exciting opportunities we're seeing on gross revenue growth, kind of in a few quarters in a row now. And so I just want to get a better sense of what you're seeing in terms of, anything structural on rebates incentives that's maybe a bit different and tied to winning business or is it just more business as usual and just maybe some comments on that. Thanks, guys.

A - Michael Miebach {BIO 16087573 <GO>}

Thank you. Let me start off here. So I want to reiterate what Sachin said before. We're trying to win portfolios that are important for market relevance perspective for us to gain access to transactions to drive our services model and follow through on that virtuous circle that I talked about earlier in my remarks. So that's the whole idea. We keep net revenue yield in mind as we do all of this. That is the integrated payments and services model that we pursue.

Now when you look at the competitive landscape, payments is competitive. There's a lot of players out on the landscape, we like competition and we feel we have a truly unique proposition between our payments and digital solutions on one hand and our services on the other hand.

So when you think about UniCredit, so why did they come to us? Well, they were looking at our proven track record in our engagement with UniCredit before the expanded relationships and supporting their customers, they like our sustainability agenda. On Citizens, it was a similar kind of mix and on Webster, yet again, it was a similar kind of mix. There is always something across the portfolio of services that sticks out. Citizens, I recall a conversation on open banking, for example. That is clearly one that mattered and the sustainability agenda yet again.

So it's a mix. There is nothing particularly new here. We always weigh off the volume growth that we can see with the incentives that we give to make this whole equation work for us in a very disciplined manner. And there is a range of deals and portfolios that we really do not want to win. So we're very disciplined about that. And I don't see anything out of the ordinary here, but I want to hand over to Sachin to give us a little more color on that.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure. So, Darrin, I think Michael covered kind of the competitive landscape. I think to your specific question around, the divergence -- not divergence, but the fact that gross revenue is growing at a faster clip and the rebates, incentives are actually impacting the growth on the net revenue side. The reality is in the growth business, right? You're investing in portfolios upfront, right?

Going back to the earlier question, which was asked, right, when you're doing a combination of fixed and variable incentives, fixed incentives start to amortize the moment a deal goes live. That doesn't mean the volumes come on at full speed when the deal goes live, right? Because like we talk, we talk about conversions happening over multiple years. We talk about -- if a conversion happens right away, you get the volume right away and you start to see the associated impact from a revenue standpoint.

So there is this lag which exists on the fixed incentives line between when we're recognizing the impact of those incentives and when we would expect at full ramp, the volumes should come on as we win deals. But that's more of a technicality as in, how the math around that works. I think the bottom line still remains, which is, we would rather be in the payment flow on a disciplined basis to be able to drive higher net revenue yield for our company than not be in the flow. So you're not in the flow, you're not getting the benefit of PCE, you're not getting the benefit of the secular trends, which are moving from cash to electronic forms of payment, and you're certainly not getting the ability to deliver certain levels of services, which we got out there. So, that's kind of the broad philosophy from a competitive standpoint that we've chosen to take here.

Q - Darrin Peller {BIO 16385359 <GO>}

All right. Thanks, guys.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure.

Operator

Next, we'll move to Ashwin Shirvaikar at Citi.

Q - Ashwin Shirvaikar {BIO 5027189 <GO>}

Hey, thanks. So I want to talk about KY Bank [ph]. It's live with JP Morgan. I mean, Verizon is piloting. Can you speak to the momentum you're seeing in the product? And given that it uses traditional ACH banking rails, could you maybe more broadly speak to the economic model for this and similar products that maybe tend to not use Mastercard yet?

A - Michael Miebach {BIO 16087573 <GO>}

Right. So this is a combination of bill pay, of open banking. This is for us sitting in a new flow space. Very specifically, what we are addressing is trying to bring value to ACH flows. These are -- somebody paying a doctor or things like that. And how do we add value to this is by plugging onto a flow that would take place and might not happen because of insufficient funds on an account. We're putting in our open banking connection to make it clear is there a balance on the account. It's called the payment success indicator. That is the product. And it is a per click fee related to the API call. So that is the model. That is bringing value to a part of the payments industry where there wasn't a particular problem to be (inaudible) anybody willing to pay for it. I think we're finding -- starting to find these corners where there is real value that we can bring.

So for us, this is TAM expansion. This is new flows. As I said, where we bring our unique combination of services together, we are in real time payments and we are in digital identity and we're in open banking. All of this is needed here to make the solution work and this is why a player like JP Morgan comes to us to do this for us, and Verizon to the point about momentum will now be piloting it. So it would be a little early to talk about momentum, but we'll come back on that as that solution is then rolled out into the market. But it is now live and that was an important point for us because it had to be built and put together and we have done that.

Q - Ashwin Shirvaikar {BIO 5027189 <GO>}

Great. Thanks (inaudible)

Operator

We'll go next to Jeff Cantwell at Seaport Research.

Q - Jeff Cantwell {BIO 18876343 <GO>}

Hey, thanks. I wanted to ask about your business update in October specifically. We can see in the U.S. switched volume growth is 5%, so that's 200 bps slower versus the 7% you did this quarter. But can you talk a little more about how you see the holiday season developing this year because we've seen some estimates that consumer spend could increase by 5% versus last year which sounds pretty good all things considered. You highlighted resilience in consumer spend this quarter. So just wanted to take your temperature on how the entire quarter might fall specifically in the U.S. Thanks.

A - Sachin Mehra {BIO 15311008 <GO>}

Hey, Jeff. So on the U.S. specifically, what you're seeing in the day 21 numbers is, like I said in my prepared remarks, right, it's primarily related to the timing of Social Security payments between this year and last year. So, that's really what you're seeing in the nature of that 7% growth in Q3, which now shows that 5% in the first three weeks of October. So there's really, from an underlying standpoint, other than that, there's not much we're seeing in the nature of a trend shift in the U.S. in the first three weeks of October.

On your question around how we see Q4 shaping up, it's actually very much in-line with what I shared, which is, our basic scenario continues to be one of where the consumer remains resilient. I mean, the reality is, unemployment levels are at all-time record lows. When people have jobs, they hopefully are getting their paychecks, which they're hopefully using towards meeting their spending needs. You also saw GDP came out this morning, and it came out pretty strong. So, I kind of generally think about this as saying our base-case scenario around consumer strength and resilience is what we're assuming going into Q4.

Q - Jeff Cantwell {BIO 18876343 <GO>}

Okay. Thanks very much.

A - Sachin Mehra {BIO 15311008 <GO>}

Sure.

Operator

We'll go next to Ramsey El-Assal at Barclays.

Q - Ramsey El-Assal {BIO 17528014 <GO>}

Hi. Thanks for taking my question. I wanted to follow up on Dan Dolev's question earlier, and basically just ask about the sort of dislocation between your valuation in the marketplace and the valuation of your distribution channels, the acquirers and banks that sort of flow transactions to you. Can you give us your updated thoughts on the overall health and TAM penetration of this core kind of value chain? When you look at the heritage distribution channels on both sides, are you seeing upheaval or are you seeing stability? In other words, is the market kind of getting the industry wrong at this point, or are you seeing changes out there that are worth calling out?

A - Michael Miebach {BIO 16087573 <GO>}

Right. Hi, Ramsey. So let me start off on that. So if you look at how our distribution has evolved over the years, the whole theme of diversification across products and segments also applies here. So we're doing a whole number of things. I talked about our work on acceptance. That is part of our distribution, where contactless, tap on phone, things like that, a whole range of new merchant groups, scaling these kind of technologies with partners like Stripe, those are all going into areas that we haven't been in.

Then you have other parts of our go-to-market. We talked about in B2B, we talked about Oracle and SAP. You go over into the world of acquirers. There's a whole range of acquirers, more traditional acquirers, which are our partners. So across the board, it's highly diversified, it's regionally highly diversified. So these blips here and there, I mean, I can't really talk about other people's business. But earlier on the question around what we're seeing in Europe, we're just not seeing it in our numbers. And because we have a highly diversified model, so whatever specific sector focus somebody has that is a partner of ours doesn't necessarily flow through for us. So I don't know if the market got it wrong or not, we're not the Oracle, but we make sure we partner with everybody to drive the overall digital ecosystem.

Q - Ramsey El-Assal {BIO 17528014 <GO>}

Got it. Thank you.

Operator

Next, we'll go to Bob Napoli at William Blair.

Q - Bob Napoli {BIO 1526298 <GO>}

Thank you. Good morning. I wanted to follow-up on commentary around open banking, banking as a service. And MasterCard also, I mean you've done a great job of partnering with a lot of fintechs. We were just at Money 2020 and I would say this year, there were a lot more regulators than I remember in the past and talking about open banking and how active they are, and reviewing all the partners in those relationships. So just any thoughts on your outlook for your open banking investments and then how you think about the regulation, the growing regulation, around open banking or banking as a service?

A - Michael Miebach {BIO 16087573 <GO>}

Right. So we continue to believe in the whole notion of open banking and open data at large where people and businesses use their own (inaudible) towards better services and propositions for them. So the idea stands, and I think the idea gets hold and hold. If you look at Europe with more regulation coming in looking at PSD3 and so forth, you're looking at the CFPB here in the United States putting out some thoughts on how regulation could look like.

For us, I put this in context of the ideas understood. How do you make it safer? What does that need? It needs trusted parties in the middle. If you can imagine a world full of a bunch of bilateral relationships where people exchange data in a not-so-safe way, that would be a bad world. That's what regulators want to prohibit. We're coming in and saying we could be one of those parties that really bring the idea to life for consumers. I can use my data for better financial services.

So when I look at what CFPB has put out, we largely support the idea. It aligns very well with our data responsibility principles that we put out. It's your data, the consumer. You benefit from it. You control it. It is our role as a company to keep it safe, and we're very good at that. So our interlocking circles stand for trust. For open banking to work, you need trust. I think that is where we're going. So we're engaging, in fact, we're oftentimes in the room when these things are being thought about. In Europe, we were very much part of the dialogue on how data privacy in this context could look like.

A - Devin Corr {BIO 23558629 <GO>}

Last question, Audra.

Q - Bob Napoli {BIO 1526298 <GO>}

Thank you.

Operator

And we'll take that last question from Jason Kupferberg at Bank of America.

Q - Jason Kupferberg {BIO 6867809 <GO>}

Hey. Thanks, guys. Just wanted to flash back to the Analyst Day two years ago. I know you had shared a three-year guide at the time for revenue CAGR of high teens through 2024, and it looks like you'll basically be right there through the first two years of that forecast period. So just wanted to take your temperature on that three-year guide. It looks like we're exiting '23 more in the low double-digit range. And really just trying to get a sense of how you're thinking about normalized top-line growth going forward with the COVID noise, essentially, in the rearview mirror.

A - Sachin Mehra {BIO 15311008 <GO>}

Jason, so, look, we're not updating anything on the three-year outlook at this point in time. It's like you said, the first year actually turned out to be a very nice year. Again, in the second year, we've delivered quite strongly year-to-date, and then we've shared with you what we think will happen from an expectation standpoint in Q4. The one thing I just want to kind of orient everybody to is, when we had the investors in November of 2021, and the world has actually changed quite meaningfully since then, which is that what I'm alluding to here is the invasion of Ukraine by Russia and our suspension of activities in Russia. So that's something to keep in mind. We certainly keep it in mind as part of the fact that what we were assuming at that point in time included Russia. Right now, obviously, we don't have revenues related to Russia, which are coming through. But beyond that, I have nothing really to share in terms of updated thoughts around our three-year outlook.

Q - Jason Kupferberg {BIO 6867809 <GO>}

Thank you.

A - Devin Corr {BIO 23558629 <GO>}

Thank you, everyone, for joining us today.

A - Michael Miebach {BIO 16087573 <GO>}

All right. So, thank you for the questions today. Thank you for the trust in MasterCard. I always thank our people, and this is, yet again, the moment to do this. Times are not that easy for everybody and they're leaning in and they're leaning in for our customers. So, thank you to everybody at MasterCard who's on the call and thank you to all of you who listened in and asked questions. Speak to you one quarter from now. Thank you. Bye-bye.

A - Sachin Mehra {BIO 15311008 <GO>}

Thank you.

Operator

And that concludes today's conference call. Thank you for your participation. You may now disconnect.