

Company Name: Mastercard Inc  
 Company Ticker: MA US  
 Date: 2017-05-02  
 Event Description: Q1 2017 Earnings Call

Market Cap: 134,831.84  
 Current PX: 125.79  
 YTD Change(\$): +22.54  
 YTD Change(%): +21.831

Bloomberg Estimates - EPS  
 Current Quarter: 1.043  
 Current Year: 4.300  
 Bloomberg Estimates - Sales  
 Current Quarter: 2971.040  
 Current Year: 12088.897

## Q1 2017 Earnings Call

### Company Participants

- Warren Kneeshaw
- Ajay Banga
- Martina Hund-Mejean

### Other Participants

- James Schneider
- Donald Fandetti
- Bryan C. Keane
- Tien-Tsin Huang
- Sanjay Sakhrani
- Darrin Peller
- James Friedman
- James E. Faucette
- Andrew Jeffrey
- Lisa Dejong Ellis
- Paulo E. Ribeiro

## MANAGEMENT DISCUSSION SECTION

### Warren Kneeshaw

#### *GAAP and Non-GAAP Financial Measures*

Both the release and the slide deck include reconciliations of non-GAAP measures to their GAAP equivalents

### Ajay Banga

#### *Business Highlights*

##### *Net Revenue and EPS*

- We're off to a very good start this year
- Net revenues are up 12%, EPS up 17% vs. a year ago
- We're also very pleased to announce that we have completed two acquisitions over the past month or so at VocaLink and NuData Security, which both complement our efforts to participate in new payment flows and enhance our safety and security offerings

##### *VocaLink*

- We believe that the future of payments is going to be defined by, first of all, choice, convenience, and security

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- And if you build a strong business based on innovation and scale in card-based retail payments, that we know, VocaLink adds key platforms to that foundation, including the technology behind the BACS ACH payments system, the real-time account-to-account Faster Payments service, and the LINK ATM network in the UK
  - This combination will enable us to take a more holistic approach to retail, P2P, and B2B payments

### ***Fast ACH***

- In particular, the potential of Fast ACH is growing in the U.S., in Europe, and actually in other markets around the world
- VocaLink has been successful in deploying Fast ACH in both developed and emerging markets
- Leveraging our broad footprint and our expertise, what we are planning to do is to scale VocaLink's capabilities and enhance the value of each transaction with the robust set of services that we provide
- And as we execute, our customers will be able to turn to one partner to address their payment needs across the whole spectrum, from cards to ACH, and thereby further enabling the shift from cash and check to electronic forms of payments

### ***NuData Security***

- We also acquired NuData Security, whose technology helps businesses detect and prevent online and mobile fraud based on understanding how end users interact with devices
- I'll give you an example
- The technology can determine how fast a password is typed or the way a user holds a smartphone to help distinguish authentic users from potential fraudsters
- The technology assesses scores and learns from each transaction to help merchants and issuers make near real-time authorization decisions
- And as the Internet of Things continues to grow with whose ever estimate you believe, it could be up to 50B connected devices by 2020, the point here is integrating NuData's technology into our layered security strategy will help consumers pay safely and conveniently however and whenever they choose to do so
- So I'd like to welcome each of our new colleagues from these two companies to our family
  - We are looking forward to working together as we pursue the many opportunities that lie ahead

### ***Global Growth***

- Now turning to the economy, broadly speaking, not much has changed since the last quarter
- We've seen modest pickup in global growth, in part due to market-specific fiscal stimulus, although uncertainty about the direction of trade policies continues to be a concern
- In the U.S., consumer and business confidence remained strong
- Employment is rising
- Wages are beginning to increase

### ***SpendingPulse***

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- And based on our own SpendingPulse report, which as you all know, includes not just Mastercard spend data but a broader spectrum of retail spend across all payment types, Q1 retail sales in SpendingPulse excluding auto were up 3.9% vs. a year ago
- Gas is about 1 percentage point of that increase
- Like you, we're still waiting for tax, trade, and infrastructure policy initiatives to come to fruition

### ***Latin America***

- In Latin America, Brazil is showing signs of emerging from its two-year recession, and we continue to see modest growth in Europe with the unemployment rate nearing a 9-year low
- Germany remains solid
- There's slower growth in the UK, Italy, and France, driven by rising inflation and some uncertainty around the impact of Brexit negotiations
- Regarding travel, we are seeing increased inbound traffic into the UK due to the weaker pound
  - However, outbound consumer spend has declined in the case of the UK.

### ***Asia***

- In Asia, despite some ongoing uncertainty in China, economic indicators show high consumer and business confidence with moderate economic growth, and India's growth continues to be strong
- We're working collaboratively with the government there to support electronic acceptance as part of its demonetization efforts
  - That's a good step towards achieving the long-term opportunity in India
- Much work remains to be done there over the next few years

### ***Volume and Transaction Growth***

- Meanwhile, we just continue to drive double-digit volume and transaction growth across most of our markets
- They're performing well against our plan, and our strong business fundamentals position us well for continuing long-term growth
- And this quarter, we gained momentum in core credit, debit, prepaid, and commercial businesses by winning new programs
- We extended some existing relationships, and we optimized the value of some of our current portfolios. So let me start with credit and debit and give you a few examples

### ***Capital One***

- We renewed a number of exclusive agreements with key partners in the U.S., including Capital One, for their signature debit card business and Bank of the West for their consumer credit, debit, and small business portfolios. We also renewed our consumer and commercial credit relationship with Citizens Bank
- We're actually highly engaged with them in delivering value-added services, smart data, inControl fraud tools, consulting, Rewards being examples

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### ***Brazil***

- We've expanded some strong partnerships like those with Itaú in Brazil
- We're actually launching a new co-branded credit card program with Itaú and Multiplus, which is a loyalty points provider and partner of LATAM Airlines
  - That secures Mastercard's leading position in that market with airline co-brands

### ***Europe***

- Across Europe, our momentum continues
- The larger banks, as you all know, are for the most part dual-issuance banks in their home countries, and what we're doing there is gaining share within their businesses
- In addition, a number of the smaller and medium-sized banks have signed some interesting deals with us
- A couple of examples include AvantCard, which is a consumer credit flip that increases Mastercard's market share in Ireland, and Bank Van Breda, which is a consumer and commercial win in Belgium

### ***China***

- China, we await clarity there still on the requirements for domestic switching
- Our local team continues to win a number of single-branded card programs in China
- Again, one example from this quarter is ICBC, where we are building on that existing relationship to launch an exclusive co-branded card program with China's second largest online travel agency

### ***Travelex***

- So prepaid, there we're the leader globally in prepaid, and we continue to make strides with new product launches
- We closed deals in every region in this quarter
- What we're doing there is also to pursue some key verticals like travel, leveraging our cross-border prepaid program management capabilities that some of you will remember we acquired from Travelex a few years ago

### ***Cash Passport***

- You heard me call out some of our initiatives there before, but let me add a couple of recent examples
- Cash Passport is a multicurrency prepaid card program
- We have launched it in 13 countries around the world
- With Cash Passport cards, what travelers can do is they can load up to seven currencies at a time and then use the card at ATMs and POS merchant locations
  - This quarter, we announced an expansion of the program, the Cash Passport program, with Canada Post as a new distribution partner through its thousands of locations

### ***Mastercard Platinum***

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- And then to give our issuers the ability to offer exclusive benefits and features to their customers traveling abroad, we have developed a Mastercard Platinum prepaid travel card, which stores balances in multiple currencies, locks in the exchange rate before you travel, and provides Platinum extras like free Wi-Fi and merchant offers and transaction alerts
- We went live with Travelex in the UK this quarter with this product
- The product was already available to prepaid issuers in Brazil and several countries in the Middle East over the last year or two

### ***Default Strategy***

- Now moving on to the digital space, we have continued momentum with Masterpass through our Digital by Default strategy
- We've added more banks this quarter, BMO Harris in the U.S., LaCaixa in Spain, to reach over 85mm enabled accounts
- On the merchant acceptance front, we're continuing to add new partners like Expedia as well as Sage, which in turn brings us 10,000 small and medium-sized merchants
- The idea is to create a variety of options for consumers to shop efficiently and safely online

### ***Masterpass QR***

- And building on our recent announcement from Masterpass QR with Ecobank in Nigeria, we're now rolling it out to multiple markets in the Middle East, Africa, and parts of Asia
- In India, we worked with the government and payment industry to develop and launch Bharat QR, which is an interoperable QR code acceptance solution, basically simplifying the ability for small and micro merchants across the country to get into the electronic payments system in a cost-effective way
- Masterpass QR is just one of the many APIs available to our partners within the Mastercard Developers Platform
- The idea is to make it easy for them to integrate with Mastercard technology and services

### ***Facebook Messenger***

- Facebook Messenger bots also leverage Mastercard's APIs
- They're now live with Fresh Direct, Subway and the Cheesecake Factory in the U.S.
- And as we discussed when we introduced our plans for the Facebook bots, they use artificial intelligence to enable consumers to interact with these merchants to build their orders and then, of course, securely check out via Masterpass, but the interesting thing is all this without leaving the Messenger platform

### ***Digital Payment***

- We're also connecting our customers for digital payments through our processing services
- I'll give you a very good example
- Recently, we signed a new multiyear deal with General Motors for Mastercard Payment Gateway Services to enable safe and secure online transactions across GM's network of 4,400 dealers and a number of service providers and various GM business units in North America

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### ***Mastercard and Samsung***

- We're doing all this and continuing to innovate in safety and security
- And this quarter, Mastercard and Samsung announced the world's first authentication technology using iris scanning to verify online purchases on a mobile phone
- Mastercard Identity Check or, as everybody else calls it, selfie-pay, will use this iris scanning technology as well alongside the photo biometric when it's implemented on the Galaxy S8 later this year

### ***Biometric Card***

- We also recently announced the first biometric card, which combines chip technology with fingerprint scans directly on the card
- And that technology can be compared to do what many of us do today when you unlock your smartphone
- It's now being used to verify a cardholder's identity for in-store purchases at any EMV terminal
- We have just finished successful trials in South Africa with a leading supermarket retailer and a bank
  - We expect trials in Europe and Asia in the coming months
- So whether it's the use of tokens and digital wallets or it's innovating in biometrics and artificial intelligence, our technology is helping to drive a seamless, convenient, and secure customer experience as part of our goal to make every transaction safer, simpler, and smarter than ever before

## **Martina Hund-Mejean**

### ***Financial Highlights***

#### ***FX***

- Before I begin, I would also like to extend a warm welcome to both the VocaLink and NuData teams
- Turning to our financial metrics, starting on page 3, you will see we have delivered another strong quarter
- Unless otherwise stated, the growth numbers I call out will be on a currency-neutral basis excluding a special item related to the Canadian merchant litigation provision
- And as you can see, there was almost no impact from FX on our numbers

#### ***Net Revenue Growth***

- Net revenue growth was 12% y-over-y and came ahead of our expectations due to healthy volume and transaction growth and a slightly better than expected FX environment
- Operating expenses increased by 11% and operating income grew 13%
- EPS was \$1.01, up 17% y-over-y, driven primarily by our strong operating performance, with share repurchases contributing \$0.03 per share

#### ***Share Repurchasing and Tax Rate***



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- During the quarter, we repurchased \$1B worth of stock and an additional \$272mm through April 27
- In addition, the effective tax rate was lower this quarter when compared to the same period last year, primarily due to more favorable geographic mix of taxable earnings
- So let me turn to page 4, where you can see the solid operating metrics for Q1
- When normalized for last year's leap day, all of our metrics would have been up by roughly another 1 ppt (sic) [Percentage Point]

### ***U.S***

- Worldwide gross dollar volume or GDV growth was 8% on a local currency basis, the same as last quarter
- U.S. GDV grew 2% and was made up of credit growth of 5%, while debit was essentially flat when normalized for the leap day effect
- Outside of the U.S., volume grew 11%, led by higher growth in Canada and Latin America, with Brazil in particular
- Cross-border volume grew at a very healthy 13% on a local currency basis, the same growth rate as last quarter
- We continue to see strength in Europe and Latin America, which was partially offset by weakness from oil-producing countries in the Middle East

### ***International Growth***

- Turning to page 5, we continue to see very good growth in switched transactions of 17% globally to 14.7B, with strong double-digit growth in all regions except the U.S
- In particular, we saw strength in Brazil, Russia, and India
- And globally, there are 2.4B Mastercard-branded cards issued

### ***Net Revenue***

- Now let me turn to page 6 for highlights on a few of the revenue line items
- Net revenue grew 12%, driven by continued strong transaction and volume growth as well as our services offerings

### ***Domestic Assessments and Cross-Border Category***

- Looking at the individual revenue line items, the difference between fees charged and volumes in the domestic assessment and cross-border categories is mainly due to pricing, which is essentially offset in rebates and incentives as well as some mix
- Domestic assessments grew 15% while worldwide GDV grew 8%
- Cross-border volume fees grew 17% while cross-border volume grew 13%
- Transaction processing revenue grew 16%, in line with the 17% growth we saw in switched transactions

### ***Other Revenue***

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- And finally, other revenue grew 12%, driven primarily by Advisors and our safety and security services
- This growth rate was lower than our recent trend and would have been 18% had it not been for two factors related to our loyalty business in Asia
- First, we are in the process of restructuring certain customer contracts to reflect a change in our business practices
- As a result, we are now netting some costs against related revenues
- And second, we determined that certain revenues are better classified as domestic assessments
- Note, each of these factors has a roughly 3 ppt impact to the growth rate of other revenues
  - However, both of these changes have no impact on our overall net revenue growth or to the bottom line

### ***Operating Expenses***

- Moving on to page 7, you can see that excluding the special item, total operating expenses increased 11% on a currency-neutral basis
- On a y-over-y basis, roughly 3 ppt of this increase was due to the accelerated A&M spend in support of the rollout of Masterpass that I told you about last quarter
- The remainder was primarily due to higher personnel costs as we continue to invest in our digital and new payment capabilities, geographic expansion, Advisors consulting services, and data analytics

### ***Volume***

- So let me turn to slide 8, and here let's discuss what we have seen in April through the 28th, where most of our drivers are similar or slightly better than in Q1
- Please remember that the y-over-y comparisons in April are aided by the timing of when Easter fell this year
- The numbers through April 28 are as follows
- Starting with switched volume, we saw global growth of 10%, up slightly from 9% in Q1, with double-digit growth in all regions outside of the U.S.
- In the U.S., our switched volume grew 3%, up a bit from Q1, with higher growth in both credit and debit programs
- And gas had about 0.5 ppt positive impact to our April growth

### ***U.S***

- Switched volume outside the U.S. grew 17%, the same as in Q1
- And globally, switched transaction growth was 17%, the same as what we saw in Q1, with similar growth rates in the U.S. as well as outside of the U.S.
- And with respect to cross-border, our volumes grew 17% globally, up 4 ppt from Q1, primarily driven by the timing of Easter

### ***Service Offerings***

- So looking ahead, our expectations for 2017 are broadly consistent with our prior estimates



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- We continue to grow our core business with a mix of new deals, renewed agreements, and the expansion of our differentiated service offerings, and there has been no major change in the macroeconomic environment
- We continue to expect net revenue will grow at a low double-digit rate on a currency-neutral basis excluding acquisitions and consistent with our 3-year performance objectives

### ***FX Impact***

- When you model this on an as-reported basis adjusted for the FX impact of all currencies, we estimate there would be a headwind of between 1 to 2 ppt to net revenue growth and a little more than 2 ppt to the bottom line given the current FX environment relative to last year
- Although our first quarter as-reported net revenue had a minimal y-over-y FX impact, we expect bigger impacts in the coming quarters due to the year-ago comps, particularly in Q2
- We expect near-term net revenue growth will be lower than later in the year due to higher incentives in new and renewed agreements and the roll-off of one agreement

### ***Operating Expenses***

- On expenses, we continue to expect y-over-y total operating expenses to grow in the high single-digit rate excluding acquisitions on a currency-neutral basis, and that FX will have about a 1 ppt benefit to as-reported operating expenses for the year
- Also of note, the acceleration of A&M spend to support the rollout of Masterpass will continue into Q2
- In particular, second quarter A&M spend will be up by about \$40mm vs. the year-ago quarter

### ***Acquisitions***

- And as a reminder, we exclude the impact of acquisitions from our performance objectives for comparability's sake, but provide some detail to assist you with your modeling for the rest of the year
- So in particular, with regards to the acquisition of VocaLink, which just closed, we expect it to improve the quarterly net revenue growth rate by about 2.5 ppt, increase total operating expenses at a run rate of roughly \$100mm per quarter, and be about \$0.05 to \$0.06 dilutive in 2017, driven primarily by purchase accounting and integration-related costs
- Finally, you should assume a tax rate closer to the bottom end of the 28% to 29% range based on our current expectations of regional mix

## **QUESTION AND ANSWER SECTION**

**<Q - James Schneider>**: I was wondering if you could maybe give us a broad update on the regulatory environment you're seeing right now. The Choice Act has been introduced into Congress and obviously includes a repeal of the Durbin Amendment in that, so any impact you would see if that would indeed pass, and then also in Europe, relative to PSD2 whether you're seeing any shift in the landscape at this point in time.

**<A - Ajay Banga>**: So it's Ajay. My view of the U.S. regulatory environment is that, as I said, I still don't see the results of all the various policy initiatives come through. I consider the Choice Act and Durbin Amendment kind of thing in the same category. I am unsure in the political environment that we're seeing right now is that a lot of these will pass through in the form that original statements make them out to appear to be. And so I'm unwilling to factor too much hope from specifics of that type. I continue to believe that in overall terms, the regulatory environment will continue to improve in this administration because that's their focus. But I don't think you can pick one item out of it

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and say that one will certainly pass. I don't think that's the way it's going to work. So that's not the way we're looking at it.

On Europe, on the other hand, there's a lot going on in Europe, but PSD2 is at very early stages. As you know, what PSD2 does is that it basically opens up, even if fully implemented, the market to many new players who could come in and play in the payments ecosystem. It also introduces a number of things that aren't as simple for merchants or consumers to handle, for example, two-factor authentication. So my general view on PSD2 is that we've got a bunch of people in our company working very hard to make sure we take the tailwinds that it will produce for a company like ours, and I assure you there are plenty of tailwinds, while also taking into account headwinds that it produces and work with banks and merchants and these new players to make sure that we can play a role that's practical and sensible to facilitate the payments ecosystem.

You've got to remember that the two-factor authentication and things like already low interchange in Europe can create some headwind for great progress from new players to come into the system. And so this isn't as simple to figure out as it may appear to be when you first read PSD2. I think over the next two, three, four, five years, you will begin to see this have a roadmap, and we are well preparing for that, both from a tailwind and a headwind point of view.

**<Q - Donald Fandetti>**: Ajay, if you look at the network results this quarter, it seems like the international markets are starting to perk up a little bit. I was just curious on your thoughts on the sustainability of that. And then if you could, maybe comment about the U.S., what your view is there, and how travel into the U.S. has been trending.

**<A - Ajay Banga>**: So, Don, you're absolutely correct that the international markets have in the last, I would say not just this quarter, over the last six to nine months, things have been moving up in the international markets. Remember, Brazil was one of those big markets for us that was holding it back. Brazil turning the corner. I wouldn't yet call it a V-shape movement, by the way. I'm looking at a kind of flat U. It's stopped declining. It's improved a bit. This is a good thing. There's a lot going on in Brazil on the political and economic environment that still has to pan out for this to be a continued improvement, but it's way better than it was a year ago at this time. So that's the first one.

The second one is remember a few things in cross-border. You look at places like France that had got seriously impacted a year ago by unsafe environment. France has actually begun to come back up, not where we would like it to be, but again improved over where it was. There are other countries that are still suffering from travel and tourism issues to do with safety.

Your specific question on the United States, inbound into the U.S., anecdotal information, not yet quite visible, but anecdotal on travel bookings in the future, on hotel bookings in the future would indicate that there is some slowdown in that. I think part of it could be just the strong dollar vs. other currencies. Part of it could be concerns around the political and stability of the social environment. It's tough to say. And, I wouldn't read too much into it yet. I think if it continues for another quarter, that will be a matter of some concern for inbound into the U.S. But international on the whole, you're absolutely correct. Things are looking decent there. Outbound U.S. travel is fine.

**<A - Martina Hund-Mejean>**: And even in Europe, as Ajay already mentioned, France, but it's really across Europe where we are seeing very strong, continued strong growth from a cross-border point of view. Ajay mentioned in his prepared remarks that the inbound travel into the UK is extremely strong, but it's pretty much offset by much lower outbound travel from the UK. But all of the other countries on the continent, and in fact, we've been seeing Russia starting to come up, people traveling a lot outside of Russia, so very strong factors there.

**<A - Ajay Banga>**: China is interesting. There is lower growth in China, but Korea and Hong Kong remain very strong, so it moves around. But if I were to focus on cross-border, it would be Europe and North America that are showing results, with Brazil as well. And then the others come a little after that.

**<A - Ajay Banga>**: But even in China, we have positive cross-border growth trends.

**<Q - Bryan C. Keane>**: Martina, maybe you can just explain the dynamic between how pricing is impacting domestic and cross-border fees and then how that gets netted out against rebates and incentives, just what that impact is, how that looks like. And then what is that going to look like going forward, and how should we model that?

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**<A - Martina Hund-Mejean>**: We have made a number of changes over the last quarter or so, basically adjusting the pricing of our various products and services offerings, and that allowed us to obviously move some of the numbers around. But net-net, I have to tell you from a pricing point of view, that was not really a big contributor for this quarter.

So what you saw that the domestic assessment fees didn't quite grow in line with GDV, you saw that the cross-border volume fees didn't quite grow in line with the cross-border volume. And that was – I'm sorry, it grew more than the GDV fee and the cross-border volume, and that was pretty much offset in the rebates and incentive line. This factor will be pretty much with us for the next three quarters.

**<Q - Tien-Tsin Huang>**: I just want to quickly clarify that I think, Martina, you mentioned the roll-off of an agreement. Did you size that and is that new information?

And then just on VocaLink, I'm curious. How has that asset performed YTD and maybe any metrics you can share? And how should we gauge the short-term performance here beyond just the revenue and expense?

**<A - Martina Hund-Mejean>**: So first of all, on the roll-off, the agreement we had mentioned that this is just something that had been with us for the last four quarters. You are going to see it...

**<A - Ajay Banga>**: Tien-Tsin, it's the USAA roll-off. It's nothing new.

**<Q - Tien-Tsin Huang>**: Okay, I just wanted to make sure. I just wanted to make sure.

**<A - Martina Hund-Mejean>**: There's nothing new. That's what it is.

**<A - Ajay Banga>**: I wouldn't leave you in suspense.

**<Q - Tien-Tsin Huang>**: Okay, I just want to make sure. I'm nutty like that, and then just VocaLink?

**<A - Martina Hund-Mejean>**: And secondly on VocaLink, just some texture beyond just the numbers that I called out this morning. They are performing really well. So we are actually very happy as we closed the agreement. They really did a wonderful job in the market in all of their various product lines, including obviously developing the app, which is a push-debit product in the UK and starting to roll that out with a number of bank partners. So we are very pleased to see that. I think that kind of trajectory will continue. Of course, this is going to be a more complicated integration, so we have everybody welcomed now for three days. We are very hard at doing the integration over the last three days, but there's another year to come. And so you will be hearing from us more as the quarters unfold.

**<A - Ajay Banga>**: Tien-Tsin, basically to me, VocaLink, at the end of the day, aside from the actual how you integrate them, I just think the opportunity to be able to go to any customer in the world and both a bank and a merchant and even a consumer eventually, and show them the ability through a Masterpass or some such event, show them from a Mastercard card to using Mastercard Send for P2P to using an ACH capability.

As we get the capability from VocaLink embedded across our system and as we can do it at different levels of complexity in different countries. In the UK, VocaLink is a full operator as well. In other countries, it's got different models there. But you'll find us over the next year or two at least at the front end trying to put as much as we can of our skills and capabilities across full payment ranges. Add to it what we can do with ESS fraud safety, artificial intelligence, decision analytics, and put all of that and bundle it together. That's our real work in the integration. That's actually probably 80% of the work that's going to happen over the next year or two.

**<Q - Sanjay Sakhrani>**: Ajay, in previous calls, you talked about the timing on China and how it's unfolding there. Obviously, Visa talked about perhaps that extending out a little bit. Maybe you could just talk about your updated thoughts on that.

And then, Martina, just one quick question on the incentives; as we look out to next year, should we expect similar growth rates to this year? Thanks.

**<A - Ajay Banga>**: Do you want to do the incentive one?

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Bloomberg Estimates - EPS  
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**<A - Martina Hund-Mejean>**: Sanjay, we are not yet ready to talk about next year. So we have been talking about the incentive line for this year, and I think I mentioned on the last quarter call that we expect about roughly a 20% increase on rebates and incentives. I think that is still roughly the number, but you're going to have to wait a little later in the year that we will be talking then about 2018. But as you have seen, rebates and incentives line has not really changed much over the last year or so, two years, and I don't expect much of a change.

**<A - Ajay Banga>**: And, Sanjay, on your question on China, what we are trying to do there is probably not dissimilar to what you heard from Al [Kelly] on his call. We are working closely with the government there to finalize our application for a domestic license. We haven't got all the details you need relating to not just the application, but even more importantly, the review process. And so this is an ongoing effort with them. And I've been saying this now in some earnings calls, as you have heard, that I wouldn't hold my breath on when this comes through. It's just work, keep at it. And as they get more comfortable with opening up their domestic payments market in a way that makes sense for their market and their economy, that's when more and more clarity will keep emerging.

We're working our way through it. I've been there a couple of times in the last three, four months. I've met everybody, so has everybody else who has been there. We probably meet similar people or one person here, one person there. But at the end of the day, I don't have much more to add to you on that. I remain focused on doing a few things. One is ensuring that we get more and more single-brand agreements signed up, and we have signed 40 – 45 or so of them last year. We signed more in Q1. And the good news is because of that, our card numbers in China are continuing to increase, even as the dual-brand card issuance or renewal rather is slacking off as some banks are moving away from dual-brand.

Now you've got to remember, not every bank is in a big tearing hurry to move away from dual-brand because they also recognize the impact on their revenue stream of moving away from it. So this is a moving target. It's a little difficult to put a numerical value to it. But the good news is our total number of cards continues to increase despite this dynamic.

And so, as Martina mentioned when I was giving the answer on cross-border, China cross-border continues to grow as well. So there's a nice little dynamic going on there. Now it's going to get a little more complicated as the year goes by on dual-brand cards, and hopefully the single-brand volume we are building will continue to give us a tailwind against the headwind of dual-brand, all this inside the ecosystem conversation of how do we get to a license in China, which to me is still some distance away. Now there are a lot of conversations going on, as you know, between the U.S. and China. With 100 days conversation to happen, I don't yet know if that will influence things materially, so we'll see.

**<Q - Darrin Peller>**: I think it was adjusted mostly around FX and maybe VocaLink being included to some extent here as well. But I guess when we look at the timing of some of the variables like USAA lapping, and we've heard a lot more about possible pricing tailwinds in Europe and others, I'm just wondering if we shouldn't expect a better growth rate in H2 than the 12% constant currency that we just saw. It was obviously 12% constant currency came in pretty strong vs. our estimate.

And then just a quick question, Ajay, on India, similar to the China question, and I guess thoughts on timing and opportunities there, if you can, just quickly update us. Thanks.

**<A - Martina Hund-Mejean>**: So, Darrin, first of all, just to explain again Q1, it did come in better than expectations. We called out strong drivers, in particular in Latin America, Asia-Pacific as well as European cross-border, and some of the transaction growth that we saw outside of the United States. And FX was more favorable than we otherwise had assumed.

One quarter does not make a year. We have also guided in my remarks that in H1, you will probably see – so that means Q2 and Q3, you probably will see some lower growth rates and then pulling back up in Q4. So at this point in time, I don't see a basis for actually making a change for what we said about the whole year.

**<Q - Darrin Peller>**: Okay. And just...

**<A - Ajay Banga>**: We are obviously working away. We're working away against our plans. Remember that's what I'm working on. Now India, how much time do you want to spend?



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<Q - Darrin Peller>: As much as you want.

<A - Ajay Banga>: So India, what's going on there is that in this first quarter, the growth rate of card spend at point of sale is still very substantial but much lower than it was in Q4. I think that's partly because currency notes have come back into circulation, and so cash withdrawal at ATMs has gone up compared to where it was in Q4.

Overall, GDV is still impacted. I think if you spoke to consumer product companies that are large in India, a Unilever kind of company, they would tell you they still see an impact on total consumer volumes and downsizing of inventory in the retail system because of some non-availability of adequate cash for transaction capability. So there's an interesting mix going on. You're seeing more electronic. You're seeing a little more cash, still not back to where it was, but it's headed in the right direction, but more importantly, headed in the right direction with some tailwind on the need to fix towards electronic vs. more cash. That's what's going on underlying all this.

Now let me give you a couple of numbers that will tell you the magnitude of what has to be done there. So there are about 840mm debit cards in India, and those have grown by 20% – 25% over the last six months. This is a huge number. But of those, 770mm of them only take out cash from ATMs. Only 70mm of them have been used more than once at a point of sale. And therefore, the total volume of the number going through these two, the ones that I use for cash at an ATM, it's \$450B a year, the ones that are used for point-of-sale transactions \$30B. So we're talking a very cash-heavy marketplace with a great deal of reliance on cash as the instrument of driving the economy. That's what they're trying to work their way through.

To give a similar example for credit cards, there are less than 30mm credit cards in India. Just compared to 840B in debit, of which 70B have been used at a point of sale, there are only 30mm credit cards. In the last six months, while the debit cards grew by 25%, credit cards grew by less than 10%. So it's an interesting dynamic. And while merchant acceptance can grow, [ph] we're north of (44:32) about 2.5mm from where it used to be, which is 1.5mm, there are 60mm over there that you could get to. I doubt you'd get to a number of them because that includes a fruit seller on the roadside who probably will be among the last few to convert to electronic. But between 2.5mm and 60mm, there's a wide number. And even if you got to 5mm, 6mm, 7mm, that would be a substantial change over the coming year.

The government is very focused on driving acceptance. That's why the QR launch. That's why they're driving new point-of-sale terminals being put into the country. What they need to do is to provide some clarity on the MDR [Merchant Discount Rate]. In January they reinstated MDR, but at lower rates. Remember, there was an MDR holiday for a couple of months in the last quarter as a way of providing the right incentive and so on.

They need to get clearer. By the end of June, they promised a final rate, and there's a lot of conversation going on between the Development Bank of India, the Finance Ministry, and the banks and all of us on what that number should be. If you don't get clarity on that, how does the bank figure out what its revenue stream will be? If they can't figure out their revenue stream, whether they're an issuer or an acquirer, how do you expect them to invest in expanding acceptance and issuance? I think the government needs to make a decision on that front to enable this momentum to continue into the second part of this year.

<Q - James Friedman>: Martina, with regard to the reclass for the other revenue, we get asked about that a fair amount. I know you had called us out that this was going to happen. I was just wondering if you had any more detail as to what it was that was requested. In other words, was it the security or was it selfie-pay or Advisor? Any more color on where the reclass took place would be helpful. Thank you.

<A - Martina Hund-Mejean>: I'm going to give you a very specific answer to this. It was in our loyalty business in Asia. First of all, we had a number of premium cards there with assessment fees. And they went into other revenues that really should be up in the domestic assessment. So it was basically just going from other revenues up to domestic assessment, and that was a 3-ppt impact.

And the other impact, which was also a 3-ppt impact, was where we actually provided in a customer engagement a particular service. And this time it was actually gift cards, where we procured the gift cards, there were costs to the gift cards, and we provided a holistic service, including program management, to that particular customer. We restructured the contract in such a way that we are not procuring the gift cards. The gift cards are procured by the customer. So that

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means they don't run – they run in such a way to our P&L that we can actually now net from a gross revenue point of view the cost of those gift cards. And so that is another change. We are not running it gross. We are running it through from a net point of view.

**<Q - James E. Faucette>**: I wanted to ask a follow-up question on the VocaLink acquisition and integration. And you talked a lot about how you look at integration capabilities and how you would judge that. How should we think about – and I think that makes sense from the context of your overall business lines today. How should we think about new opportunities for VocaLink once this is fully integrated? I guess one of the things that we look at is the B2B segment is quite large. Does it make sense for Mastercard to start to explore more aggressively some of those opportunities? I'm really just looking for an expansion on the thought process on the VocaLink roadmap. Thanks.

**<A - Ajay Banga>**: Sure, look. You're definitely going to see us expanding this capability into, first of all obviously Fast ACH and what that does with, for example, the Pay by Bank app in London and the UK that's rolling out. That basically is like a product that is a debit similar product but doesn't use a debit card to be able to make a payment from an individual to a merchant. We clearly see that as an opportunity for our company to grow our business in a number of markets around the world.

So that doesn't require us necessarily to be operating the entire payments infrastructure of a country. It's a product and an app that you can put at the front end, so long as the country has better ACH systems. So you'll see us using that in a number of countries around the world and improving it as we go along over the next couple of years. You should think about it as a two, three-year effort.

The second part clearly is that we could take their effort and attach our capability of fraud detection, early warning systems, SafetyNet, Decision Intelligence, all these products that we've been launching in the fraud and safety space, we could begin to attach those to ACH systems where VocaLink has a role to play. By the way, we're already talking about attaching these tools to ACH systems that VocaLink does not have a role to play as well because this is not determined only by what the front end is. It's determined by our ability to provide that service to ACH type of systems. But clearly, if it's VocaLink there, we've got a better opportunity to introduce these products with some value exchange built into it. So you should see therefore those two kinds of efforts being business development in some ways.

A third one would obviously be the extension of this use into both P2P as well as B2B usage. And we've already made a fair amount of effort in the B2B space as a company. We have been in the last, I'd say two years, I think the last Investor Day, if I remember correctly, we had a pretty deep dive on our B2B and commercial efforts. But even recently, we've launched Straight Through Processing. We've done a deal with Amadeus, which is a leading travel technology company. We've done the launch of Easy Savings cross-border. Our company is making a fair amount of effort in the commercial space. And the availability of VocaLink's capabilities where they are operating just makes it easier for us to make progress there.

Remember, all of this is contingent upon VocaLink either being in the marketplace as an operator or our ability to apply the front end of its capabilities, like Pay by Bank in certain markets, in which case the market must have a Fast ACH system or different aspects of our safety and security and loyalty services that we could provide whether VocaLink is there or not. And that's the range of things we're doing.

One of the good things that's happening is that we're getting some excellent talent from VocaLink. They understand the ACH, Fast ACH, back-switching, LINK ATM systems. That's a great add to our company's capabilities. David Yates, who was the CEO of VocaLink, is joining our management committee and will be focused on helping us think about how to do exactly what you asked in different markets. So I'm pretty excited about this. And if you would see me right now, you would find I have a degree of real intensity around this topic over the next two to three years.

**<Q - Andrew Jeffrey>**: I appreciate you taking the question. In terms of switched transactions, you had some pretty robust growth. I wondered if you can talk a little bit about market share by region and continued momentum, and if indeed that is one of the key drivers behind that line item.



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**<A - Martina Hund-Mejean>**: Andrew, I'm going to take that. And you're absolutely right. This is now three quarters or so in a row that we had 17% switched transaction growth, which is absolutely terrific. The growth is really coming from Asia-Pacific and Middle East-Africa, in particular in Australia, India, South Africa, even in Nigeria, even though we all know that, that country and economic environment has a little bit of a tough time at this point in time.

In the EU – in Europe, our European region, there are very good growth metrics from a switched transaction point of view. The areas that I can be calling out to you is the UK, but even France, where we weren't able to be able to switch as much before, and we have been winning a number of agreements where we can now switch. In Russia, we continue to switch. And in Latin America, Ajay was already mentioning Brazil where we're seeing some growth.

The last really bright item that I can call out for you is PIN switching in the United States. That has been really well into the double-digit space over the last three quarters, and that was a combination of the kind of work that we have been doing with issuers in order to get on the back of the card as well as with merchants on the routing opportunities.

**<Q - Lisa Dejong Ellis>**: Ajay, I have another question about India. Paytm in India was – or is I guess now classified as a so-called payments bank. And I'm wondering – which I guess appears to be somewhat of a hybrid between a traditional bank and a money transfer agent. I'm wondering. One, are you seeing these constructs crop up elsewhere around the world? And then also, how do you think about your value proposition as Mastercard to that kind of entity?

**<A - Ajay Banga>**: Lisa, the way the payments bank topic in India developed was that there was a report put out by the central bank or the Reserve Bank as it's called in India. They commissioned a report, and they put out an idea, how do you grow acceptance and electronic payments in the country. And one of the items in there was to add on the idea of payments banks, where they wouldn't have the same infrastructure and the same need as a traditional bank, but they could help to reach these underpenetrated lower volume, lower density of population areas to expand the distribution of electronic payment products.

There are other countries that have done similar things. They call them differently. In Mexico, for example, the correspondent banking network does something similar where you could put the ability to have a terminal in a retail store in a small town in Mexico, and that could be used for both simple deposits and simple withdrawals. So different countries have gone to different extents on this, and it's been going on for quite a few years.

The specifics of Paytm are the following. Paytm mostly until now has been operating as a closed-loop prepaid wallet. So they've got to build their own acceptance, which is challenging. Now the input into the wallet was credit, debit, and bank accounts, a bit like PayPal of old. That's a staged wallet. As you know, we don't think staged wallets provide transparency for either the merchant or the consumer or the bank, but that's a different challenge. But what they were basically doing was a prepaid closed-loop wallet.

When the government announced the demonetization, clearly whichever outlet you were accepted in and if you spent a lot of effort to grow your acceptance, which is one of the things they're going to do with whatever money they are now getting injected into themselves over the next few months, depending on what deal finally gets struck by new investors, they're going to try and expand their acceptance.

Meanwhile, the payment bank side of them is currently a different legal entity. I don't exactly know how that will work out over time and how it will get connected into Paytm or not. But they're going to have to use – at that point in time they're going to have to think about an open-loop system. That's part of the payment bank system.

So this is going to be an interesting movement, and we're clearly talking to them. We think they're interesting partners, as I'm sure other networks are. And that's where they are right now. So I don't know if that's a clear enough answer, but it's a moving dynamic on the ground there in India.

My general view of all such players is that you've got work with them as partners because they're a channel for a consumer to reach either another consumer or a merchant, and that puts us in the middle of those payment flows. And with ACH capabilities if you could go into countries and start offering them, it puts us even better in the middle of those the same flows while at the same time developing our own alternatives in the form of Mastercard with a full suite of capabilities over time for a consumer and bank to use, whether it be card rails or ACH rails or Mastercard Send. And

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that's the way can I think about this, a fully competitive, open-loop system driven on the quality of service and driven on the quality of other services that you can attach to them, whether it be fraud management or processing or loyalty or data analytics. And that's why you see our strategy the way we're working on it.

**<Q - Paulo E. Ribeiro>**: Couple of quick questions here, one on the processing side. Can you tell us a little about the opportunity that you see in Europe? You've mentioned in the past that the separation of scheme and processing could offer an opportunity.

And second, in the U.S., we saw last year some problems with the Green Dot rollout. Can you give us an update where you are and again where you see opportunities here?

And if we can squeeze just a quick one on VocaLink, you guided in the past to \$0.10 dilution for the 24 months after. Is that still the case because you mentioned the impact on 2017 obviously? Thank you.

**<A - Martina Hund-Mejean>**: On VocaLink, Paulo, its \$0.05 to \$0.06 dilution for the year.

**<Q - Paulo E. Ribeiro>**: Okay, so it's just – so 2018, you're not talking about 2018 yet.

**<A - Martina Hund-Mejean>**: No, we are not talking about 2018 at this point in time. But typically, something like this takes about two years to integrate. So I wouldn't be surprised if it's probably another \$0.05 in 2018. But 2017 is \$0.05 to \$0.06.

I said \$0.05 before, and you might wonder because we now have only eight months of integration vs. 12 months that we had under the underlying \$0.05. Why is it roughly still the same number? Our team is actually trying to get in eight months the same work on integration done that we had otherwise thought that we would need to take 12 months. So it's going to be very similar costs that we're going to put into those eight months vs. what we had in the 12 months.

**<A - Ajay Banga>**: On the processing and switching side, honestly I'm assuming you're referring mostly to Europe. But in Europe, we're pretty confident and comfortable with the way in which we are managing the clarity that the European Commission has provided on the rules on what's meant to be handled in that space. And as you know, they insisted on a certain kind of separation. We think we've done a pretty good job of managing those. I don't feel that there is a lot of headwind against us on that topic. Our teams are aligned on the ground correctly, meaning they're not supposed to do certain things together. They're supposed to report separately. All that is set up and moving at full speed. We have not got any hesitation on that front.

For the rest of processing, we're continuing to do some really interesting things there. I read out in my prepared remarks the example with General Motors and Mastercard Payment Gateway Services. There are examples like that in the prepaid space. That's the Green Dot part that you're referring to. We are actually rolling along well with those conversions, and there are examples of that type in the Travelex prepaid program management that we bought. I read that out in my opening remarks as well to give you an example of how they're using it for prepaid travel. So in general, life is progressing well in the processing and switching space.

## Ajay Banga

### Q1 Highlights

#### Revenue

- The first one, I hope you got the sense we're off to a good start to the year
- We understand what we've got to get done for the rest of the year
- And as Martina has made some effort to point out to you, we understand how the dynamics of revenue for the year will move

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- We are spending money on Masterpass again in Q2
- Don't forget that
  - That's a good thing
- It's helping us build our awareness and our capabilities on Masterpass, all with good underlying fundamentals

### **VocaLink**

- What I'm really excited about is the capabilities that our recent acquisitions are bringing, and we're looking forward to developing new revenue streams and driving growth
- We recognize that VocaLink has a very vital role to play in the UK payments ecosystem. You should know, we have committed to maintaining the appropriate stewardship of that very important asset, hence my comment and Martina's comment about focusing on integrating it the right way
- But at the same time, we are going to be looking for opportunities to leverage their capabilities elsewhere in the world, and we're just very excited about having completed that acquisition in a relatively quick timeframe.

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