

Q3 2017 Earnings Call

Company Participants

- Ajay Banga, President, Chief Executive Officer & Director
- Martina Hund-Mejean, Chief Financial Officer
- Warren Kneeshaw, Executive Vice President, Investor Relations

Other Participants

- Bryan C. Keane, Analyst
- Craig J. Maurer, Analyst
- Dan Perlin, Analyst
- Darrin Peller, Analyst
- David M. Togut, Analyst
- Donald Fandetti, Analyst
- James Schneider, Analyst
- Jason Kupferberg, Analyst
- Jeff Cantwell, Analyst
- Lisa Ellis, Analyst
- Sanjay Sakhrani, Analyst
- Tien-Tsin Huang, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Casey, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mastercard third quarter 2017 earnings call. Thank you. Warren Kneeshaw, Head of Investor Relations, you may begin your conference.

Warren Kneeshaw {BIO 16549173 <GO>}

Thank you, Casey. Good morning, everyone, and thank you for joining us for our third quarter 2017 earnings call. With me today are Ajay Banga, our President and Chief Executive Officer; and Martina Hund-Mejean, our Chief Financial Officer. Following comments from Ajay and Martina, 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 to accept registrations.

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You can access our earnings release, supplemental performance data, and the slide deck that accompany 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 currency-neutral basis and exclude special items and the impact of acquisitions unless otherwise noted. Both the release and the slide deck include reconciliations of non-GAAP measures to their GAAP equivalents.

As a reminder, we've added a table in the release which provides additional information about the impact of Article 8 of the EU's payments regulation on our GDV and purchase volume growth rates. Our comments on the call will be on the basis of rates adjusted for these impacts.

Finally, as set forth in more detail in our earnings release, I would 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 release and in our SEC filings. A replay of this call will be posted on our website for 30 days.

With that, I'll now turn the call over to our President and Chief Executive Officer, Ajay Banga. Ajay?

Ajay Banga {BIO 4676567 <GO>}

Thank you, Warren, and good morning, everybody. So we're continuing to execute against our objectives and pleased with our record financial performance this quarter, delivering a net revenue growth of 17% and an EPS growth of 23%. Our view of the global economy remains generally positive, largely unchanged from last quarter. In the U.S., we continue to see steady economic growth, low unemployment and inflation. Consumer sentiment is favorable. We believe that although the recent hurricanes and weather impacts have had significant localized impacts, I think they're demonstrating a limited effect on the U.S. economy overall.

According SpendingPulse estimates, U.S. retail sales increased during this last quarter by 4.2%, ex auto, ex gas, a little bit better than the quarter prior to that. Economic growth in Europe is steady, driven by Germany and France, with an upward trend in consumer confidence and lower overall unemployment. In the UK, the outlook is a little more mixed with unemployment rates the lowest in years, but with concerns over the potential impacts of Brexit dampening consumer and business confidence. Latin America, meanwhile, continues to show signs of improvement, with better economic activity in Brazil, stability in Mexico, and that is despite the short-term disruptions from the earthquakes in Mexico. In Asia, consumer confidence was broadly positive. Most ASEAN economies remain steady.

And with that backdrop, we're continuing to focus and execute on our strategy. We're seeing double-digit volume and transaction growth across most of our markets. So I'm going to keep our business highlights brief today - we just spent time updating you at

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Investor Day - but we've got a couple of things to talk about. So firstly, we continue to be pleased with the progress on our acquisitions, including our most recent ones, NuData Security and Brighterion, which enhance our capabilities in behavioral biometrics and artificial intelligence. Integration activities are well underway.

We're also off to a good start at Vocalink. Our fast ACH technology will be launched in the U.S. soon with The Clearing House, and we've just gone live yesterday, in fact, in the UK with a new image-based clearing system for the check and credit clearing company, which basically helps to speed up the traditional approach by digitizing that process. And of course, as we've said in the prior earnings call and at Investor Day, we are active with Faster Payments business development efforts now in each of our regions.

Turning to partnerships. We have established a truly global partnership with PayPal, having expanded our U.S. and Asia Pacific strategic partnership to Europe, Canada, Latin America, and the Middle East and Africa. What this means is that we now have similar commitments across every region to enhance customer choice, including making Mastercard a clear and equal payment option within the PayPal wallet.

It includes implementing Masterpass through Braintree to expand our digital acceptance footprint and enabling consumers to cash out PayPal balances through Mastercard Send. And this global partnership is above and beyond the extensive programs that we have developed with PayPal over the last several years. We are their partner for all of their credit and debit co-brands globally and have additional commercial and prepaid solutions in markets with them like the UK and Italy.

In the U.S., we continue to see some good momentum. In addition to the Bank of America consumer credit deal that Craig announced at Investor Day, we have locked in some additional business in the consumer credit, debit, and prepaid side. And one example is a new prepaid program with ADP, which is the largest payroll provider in the U.S. In commercial, building on our previous discussions of the Mastercard B2B hub, we're just actually very pleased to announce our first customer, Fifth Third Bank, who will offer this platform to small and medium-sized businesses that want to simplify their accounts payable processes.

Beyond the U.S., we continue to extend relationships and win new business around the world, starting with Europe. We're continuing to make progress on deal flips and new business wins, such as with Santander in Poland and Banque Travelex in France, just to give you a couple of examples. In Asia, we're very pleased to announce that Mastercard will be Costco's exclusive co-brand partner in Japan starting early next year. And while in Asia, we've also entered into a comprehensive agreement with Uber that goes beyond acceptance to include activation and usage campaigns, as well as Masterpass integration in selected markets with them.

And in the Middle East, one of the largest banks in Saudi Arabia, National Commercial Bank, has signed a long-term exclusive consumer debit and prepaid deal for new and renewed issuance that's committed to enhance those portfolios with Mastercard Advisors

and loyalty services. And further, this is the customer to be the first issuer of Masterpass for its cardholders in Saudi Arabia.

Now shifting to some work we're doing on the product side. It's no secret right now that protection of consumer data is a hot topic. Safety and security is a key priority. We have a multilayered strategy that helps our customers better manage their own security while also protecting the overall ecosystem. In the past, we've talked about and shown you Safety Net, which identifies large-scale fraud attacks and blocks transactions in real time, trying therefore to save our customers from significant losses. And this quarter, we added to our tool set with what we call the Early Detection System, which alerts issuers to accounts that are at risk of future fraudulent activities, even before they have been used in an unauthorized transaction.

Like Safety Net and all our fraud products and services, this predictive tool leverages the power of the Mastercard network to supplement issuers' own fraud defenses. Early Detection System also combines external data and insights to generate confidence levels to help our customers determine the appropriate action to take - could it be monitoring transactions more closely or shutting down a particularly affected card immediately based on how likely it is that an account will be used for fraud in the future and how quickly that may happen.

We've also been working to enhance the security of digital transactions through the tokenization of cards stored on a merchant's website or in their app. When consumers keep their cards on file, as some of you probably do, checkout is faster, more convenient. Merchants can easily process recurring payments. Now, when you tokenize the credentials that are kept on file, it becomes useless if a fraudster steals them and attempts to use them somewhere else.

And Netflix is our first customer going live with this capability. It's also our first customer using our APIs to connect directly to what we call our Automatic Billing Updater to be able to keep payment credentials up to date in real time when an expired, lost, or stolen card is replaced. These types of account continuity tools bring significant value to merchant businesses and have helped our customers reduce declined transactions in some cases by more than 25%.

Now moving on to Mastercard Send. As you know, we've got some unique capabilities in this push payment solution. It reaches pretty much all debit cards in the U.S., reaches many other endpoints, cash-out locations, mobile wallets, bank accounts in over 100 markets worldwide. This quarter, we're continuing to help our partners deliver money faster to their consumers.

And let me give you a couple of examples. American Red Cross, where we've enabled real-time disbursements to consumers' personal debit cards for emergency response relief like in Texas and in Florida. But another example is Western Union, whose U.S. customers will now have the option to receive funds from other family members and relatives in the U.S. directly to the debit cards that they use every day.

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We're continuing to invest in Masterpass, both in terms of expanded acceptance and promoting consumer awareness. We've signed a number of new merchants, including Verizon Wireless, Home Shopping Network in the U.S., TGI Friday's, Avon, and Carrefour, which is enabling in-app purchases in Europe. And we're now live as the exclusive digital wallet with Pizza Hut in four markets in Asia. We also launched Masterpass in Mexico this past quarter.

And while on the innovation front, Garry Lyons spent some time at Investor Day talking about some of the exciting things we're doing as we expand our acceptance reach through the Internet of Things. We're partnering with companies like Fitbit and Garmin and leveraging our tokenization MDES platform to enable consumers to pay by simply tapping their smartwatches in approximately now 7 million contactless merchant locations globally.

From wearables to connected spaces, we're actually piloting a fully digital experience at WeWork. And WeWork, as you know, is the shared workspace community. You can use metered payments there for members to pay for the amount of time they're sitting at their desk and to purchase food with Masterpass, all without taking out a card or even a digital wallet. Masterpass is also powering payments through virtual reality with a shopping app recently launched with Swarovski, as well as an augmented reality shopping experience with Saks Fifth Avenue that uses Identity Check Mobile with iris authentication to make purchases. So all in all, fun and games on the innovation front.

With that, let me turn it over to Martina for an update on our financial results and operational metrics. Martina?

Martina Hund-Mejean {BIO 3677291 <GO>}

Thanks, Ajay, and good morning everyone. So while Ajay is always covering the cool things, I'm going to review with you the numbers now. So as you can see, the highlights on page 3, we have delivered another record quarter. Foreign exchange had a benefit to as-reported results, primarily due to the strength of the euro. For the remainder of my remarks, I will call out the growth numbers on a currency-neutral basis.

Net revenue grew 17% driven by strong underlying performance, and includes approximately a 2.5 ppt benefit from acquisitions. This was in line with our previous expectations. Operating expenses increased by 19%, and that includes an 8 ppt impact due to acquisitions, and that's primarily Vocalink. Operating income was up 14%, while net income was up by a healthy 19%, benefiting from a lower tax rate. EPS was \$1.34 per share, up 23% year over year, driven primarily by our strong operating performance, with share repurchases contributing \$0.04 per share. And during the quarter, we repurchased \$838 million worth of stock and an additional \$286 million through October 26.

Now let me turn to page 4, where you can see the operating metrics for the third quarter. The worldwide gross dollar volume, or GDV, growth was 10% on a local currency basis, and that's up 1 ppt from last quarter. The U.S. GDV grew 6%, up 3 ppt from last quarter,

and was made up of credit and debit growth of 9% and 4%, respectively. And outside of the U.S., volume growth was 12%, up 1 ppt from last quarter.

We continue to see strength in the Europe and LAC regions. First (sic) [Third] quarter volume grew at a healthy 15% on a local currency basis, with solid double-digit growth across all regions. Europe continued its strong performance, particularly from the UK and Germany. And in LAC, we saw a steady growth in Brazil, while Asia Pacific was led by South Korea and China. And finally, we saw the U.S. return to double-digit growth.

Turning to page 5. Here you can see switched transactions continued to show strong growth at 17% globally. And similar to last quarter, we saw double-digit growth in all regions outside of the U.S., led by Brazil, Russia, and India. And globally there are 2.4 billion Mastercard and Maestro-branded cards issued.

So now let's turn to page 6 for highlights on a few of the revenue line items, again, described on a currency-neutral basis unless otherwise noted. As I already mentioned, net revenue grew 17%, which includes approximately a 2.5 ppt benefit from acquisitions, and was driven by robust transaction and volume growth, as well as strength in services. Rebates and incentives grew 19%, reflecting higher volumes and incentives for new and renewed deals.

Looking quickly at the individual revenue line items. As we have commented during the first half of the year, the difference between fees charged and volumes in the domestic assessment and cross-border categories were mainly due to pricing, which was essentially offset in rebates and incentives, as well as some mix. This continues to be the case. However, the effect is less pronounced in the cross-border line this quarter.

So domestic assessments grew 14%, while worldwide GDV grew 10%. Cross-border volume fees grew 15%, the same as cross-border volume growth. And transaction processing fees grew 21%, primarily driven by the 17% growth in switched transactions, as well as revenues from our various service offerings. Finally, other revenues grew 19%. As a reminder, most of the Vocalink revenue shows up in this line. Advisors and Safety & Security revenues were also up. These items more than offset the 4 ppt impact from the changes we made to our loyalty business in Asia that I've called out previously.

Moving to page 7. You can see that total operating expenses increased 19% on a currency-neutral basis. This includes an 8 ppt impact from acquisitions, primarily from Vocalink and including of course the related impact of purchase accounting and integration-related costs. The remainder was due to our continued investments in digital, geographic expansion, and Advisors capabilities as well as increased A&M spend related to the Masterpass awareness campaign that we've been discussing since the beginning of the year.

I'm going to turn now to slide 8. And let's first discuss what we have seen in October through the 28th of October, where all of our drivers are similar or better, with the exception of cross-border, which was slightly down. Each of these drivers was generally in line with our expectations. So the numbers through October 28 are as follows: Starting

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with switched volume, we saw global growth of 13%, up 2 ppt from what we saw in the third quarter, with healthy double-digit growth in all regions outside of the U.S. In the U.S., our switched volume grew 9%, up 4 ppt from the third quarter, with higher growth in both credit and debit programs. Switched volume outside the U.S. grew 17%, the same as the third quarter. And globally switched transaction growth was 19%, up 2 ppt from what we saw in the third quarter, with similar or higher growth in every region, including the U.S. And finally, with respect to cross-border, our volumes grew 14% globally, down 1 ppt sequentially, with slower growth in Europe.

Now looking to the full year of 2017. Our underlying business fundamentals remain strong as we grow our business through a combination of new and renewed agreements, as well as our expanded set of service offerings. We continue to expect year-over-year revenue growth to be at the high end of the low double-digits range on a currency-neutral basis and excluding acquisitions, as we commented on at the recent Investor Day. As a reminder, the fourth quarter tends to be a period of increased deal activity, and we expect higher rebates and incentives sequentially. Foreign exchange is expected to be a slight benefit to the top and bottom lines for the full year.

A few other items of note. On expenses, primarily as a result of increased Masterpass spend, we now expect operating expense growth to be at the top of the high single-digit range for the year on a currency-neutral basis, excluding acquisitions and special items. We continue to forecast recent acquisitions, notably Vocalink, will be about \$0.05 to \$0.06 dilutive in 2017, driven primarily by purchase accounting and integration-related costs. You should now assume a tax rate closer to 27% for the year, based on our current expectations of regional mix and discrete tax benefits realized year to date, with a tax rate of approximately 28% in Q4. As is our normal practice, we will defer any comments about our 2018 outlook until our year-end call in the New Year.

With that, let me turn the call back to Warren to begin the Q&A session. Warren?

Warren Kneeshaw {BIO 16549173 <GO>}

Thank you, Martina. We're now ready to begin the question-and-answer session. In order to get to as many people as possible on the call, we ask that you limit yourself to a single question and then queue back for additional questions.

Q&A

Operator

Your first question comes from the line of Jeff Cantwell from Guggenheim. Your line is open.

Q - Jeff Cantwell {BIO 18876343 <GO>}

Hi, good morning.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

Good morning, Jeff.

Q - Jeff Cantwell {BIO 18876343 <GO>}

Good morning. Thanks for taking my question. Just had a high-level question. There was a lot of talk about blockchain at Money 2020. And of course you guys just had an announcement about opening up your blockchain API for banks and merchants. I was just hoping - can you talk to us at a very high level about how Mastercard's blockchain is going to be combined with banks and businesses? Just want to understand the use cases, the value your blockchain brings to the table. I guess, most importantly, just want to understand how you're thinking about blockchain right now, why it's important to Mastercard? Thanks very much.

A - Ajay Banga {BIO 4676567 <GO>}

So I think blockchain has a whole ton of potential use cases, and I think the real question that you're asking is how will that connect to our traditional customers. So what I'm trying to give you a sense of is we've been investing in our own platform in blockchain, not just to create our own blockchain, but to really learn how blockchains work. So whether we, in the future, operate only off our own platform or we operate as a facilitator for other people's blockchains, the objective is to be confident and knowledgeable on how they operate.

So we've filed a number of patents in the space in our own blockchain and our own platform. We have developed APIs, and we've also done things like making investments in organizations like the Digital Currency Group, which enable us to look at the way other people are innovating using their blockchains.

So what you saw at Money 2020 was that blockchain platform and APIs, and there was a hackathon there, and 60 teams of developers tested on them successfully. But the idea is that we will open this up to financial institutional merchants so they can connect into our settlement network. But remember, this is early days. Don't expect this to be a switch that gets turned on tomorrow. It has to be built country by country, connecting into settlement networks and the like.

The initial focus is on the B2B space, because we continue to believe that the challenges of speed, of transparency and costs, both in domestic and cross-border payments in B2B, are more interesting than trying to find technology looking for a problem to solve in consumer payments that consumers do not perceive. So to us there's a bigger opportunity in B2B. We're working on three or four ways of making the blockchain solution that we are trying to put out there different from others, and the first one is on privacy. So that we're trying to make sure that transaction details are shared only among the participants of a transaction, while you've got your (24:37) or you've got a permissioned blockchain.

The second one is flexibility. So you can use these APIs, combine them with other APIs on Mastercard, and maybe create a range of new apps. Third is scalability. Obviously, if we

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can connect it into our whole system and to use our leg network rules, then scalability becomes possible, and therefore reach. Because through our system, over time, you could reach into everywhere we operate with our settlement network.

That's what we're up to. Now, it's not currently by itself. We've got a bunch of things going on here: virtual cards, Mastercard Send, Vocalink, all of which are aimed at supporting cross-border and domestic B2B payment flows. And so that's what we're up to with the blockchain.

A - Warren Kneeshaw {BIO 16549173 <GO>}

Next question, please.

Q - Jeff Cantwell {BIO 18876343 <GO>}

I appreciate that. Thanks very much.

Operator

Your next question comes from the line of Darrin Peller. Please state your company. Your line is open.

Q - Darrin Peller {BIO 16385359 <GO>}

Hi, thanks, guys. You know, purchase volume, I mean, even adjusted for Article 8, accelerated a couple of hundred basis points versus last quarter and came in pretty well versus our numbers. Can you just talk about really more what's driving, in your view, the outperformance in these trends, maybe compare underlying macro to secular shifts around digital, some comment on what e-comm growth was, and then maybe what was market share? Just break it down a little more for us; that'd be great.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

Yeah, So, Darrin, it's Martina. Let me take that first. In terms of some of the drivers, when you look at the U.S. drivers, while obviously can see them as behaving a little bit better, they are spending a little bit more, most of the quarter-over-quarter performance is really due to the lapping of USAA. When you look at the rest of the world, the rest of the world is actually really doing well.

In Asia Pacific, if I just go around the world, in Asia Pacific, China, at this point in time, is not a drag. In fact, when you look at our cross-border volume, China is actually a really nice additive growth component. In Russia, we actually had the expansion of a number of agreements, and therefore we've been doing very well on Russia. In Sweden, so also in Europe, we have had a flip, so that is also very nice additive to the numbers. And then the Latin America is continuing to perform as well as it did actually in the prior quarter - it's right in the mid-teens - but that is mostly led by Brazil, as Ajay has already said. Mexico kind of stabilized with the kind of numbers that we are seeing.

Q - Darrin Peller {BIO 16385359 <GO>}

Okay. Can you give any more sense in terms of is this market share versus underlying trends in spend in macro or digital or anything else?

A - Martina Hund-Mejean {BIO 3677291 <GO>}

That's what I just called out. In the United States, it's between what the economy's doing and the lap of USAA. Outside of the United States, I just called out for you a number of areas where we are actually gaining market share. When you just look at our European region, for instance, they're in the high teens, growing in the high teens, at this point in time.

Q - Darrin Peller {BIO 16385359 <GO>}

Okay. All right. That's helpful. Thanks, guys.

Operator

Your next question comes from the line of Don Fandetti from Wells Fargo. Your line is open.

Q - Donald Fandetti {BIO 6095992 <GO>}

Good morning. So, Ajay, clearly fundamentals are good here in the quarter. So I just wanted to check in on the regulatory environment, in particular in the U.S. It seems like it's pretty quiet and manageable right now. Would you agree with that? And are there any emerging hotspots globally that we should be paying attention to?

A - Ajay Banga {BIO 4676567 <GO>}

On the regulatory environment, honestly, I - whenever he talks to me about what I think about, I think about cybersecurity and regulatory. That's the two things that anybody in this industry - and I mean not just payments, but broader industries - we should be careful about. Because there's an environment where, with more and more connected devices, cybersecurity becomes important, and there's an environment in politics around the world where regulatory becomes really important.

I would tell you that, yes, in the U.S. right now, if anything, including in today's newspaper you can see about the administration working really hard to roll back some of the regulatory changes in many industries that were put in place over the previous eight to 10 years. That is correct. But on the other hand, in every other region around the world, we keep a very close eye on this.

As I said on one of my previous calls, our country managers are now - in their goals is a very clear objective to remain very close to anything that could impact the franchise locally, whether it be policymakers, opinion leaders, regulatory changes, or litigation, not just clients, but all those things. And so we're on them at all points of time. What's going on is there are a number regions in the world where earlier domestic payment schemes were very active. Some of those regions, those domestic payment schemes for reasons of

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being unable to keep pace with technological developments, mostly – that is the reason – they end up tending to open up compared to where they used to be.

So Europe is an example of that, and there are other examples in Brazil and Colombia and markets in Latin America where that's happening. On the other hand, in markets and parts of Asia and Southeast Asia, you find a renewed surge of thinking around domestic payment schemes. And so whether it be in Indonesia or in China or in India, we're constantly working with those countries, trying to figure out how our technology and our services and our artificial intelligence capabilities can help them deliver value-added services over and beyond what they could try and do if they were trying to do this themselves. And that's how we partner with them. That's the story in Russia as well. So it's a big story.

Q - Donald Fandetti {BIO 6095992 <GO>}

Thank you.

Operator

Your next question comes from Bryan Keane from Deutsche Bank. Your line is open.

Q - Bryan C. Keane {BIO 1889860 <GO>}

Hi, guys. Good morning. Martina, just thinking about pricing, I know you talked a little bit about it, how it's changed slightly. Just want make sure I understand what the impact was there. And secondly, just on FX, as we do our models, just an update on impacts, movement in the euro and the real and any other major currencies. Thanks.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

On the pricing side, really no change, as I called it out in my prepared remarks. As you know, for pretty much the beginning of the year, we have been reshuffling pricing, where you see some of it coming up in domestic assessment as well as in cross-border, which you continue to see for this quarter. But it was essentially offset in the rebates and incentives line. So really no change in that. And we're going to have one more quarter, the fourth quarter, of this.

From a foreign exchange point of view, really what you're going to have to look at for the total year, full year, I think there's continue to be just a slight benefit to the top line as well as to the bottom line. So when you extrapolate rates of today, of course you're going to see a little bit more of a benefit for the Q4 numbers if those rates continue to persist.

Q - Bryan C. Keane {BIO 1889860 <GO>}

Okay, great. Happy Halloween.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

Happy Halloween to you, too.

A - Ajay Banga {BIO 4676567 <GO>}

Yeah, exactly.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

And to your kids especially.

Q - Bryan C. Keane {BIO 1889860 <GO>}

Yeah, exactly. It's a big day today in the Keane household.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

We know.

Operator

Your next question comes from James Schneider. Caller, please state your company. Your line is open.

Q - James Schneider {BIO 15753052 <GO>}

Goldman Sachs. Good morning, thanks for taking my question. I was wondering if you'd maybe kind of step back a little bit and talk about now that you have had Vocalink for a little while, and there's been a lot of discussion you provided and detail at your Investor Day, when do you think the B2B payments opportunity specifically will begin to be notable in the results? Is this something we can expect in terms of noticeable impact in the next two to three years, or this is more of a kind of a five-year time horizon? Maybe just kind of give us a sense about how that's different between the consumer-facing parts of the ACH business versus B2B.

A - Ajay Banga {BIO 4676567 <GO>}

So B2B as a whole, you're seeing results already because we're approaching that channel, not just through Vocalink, but through all the other things we're doing, from the B2B hub we talked about or virtual cards. Now, back to our Investor Day, virtual cards address only the cardable portion of that spend. It's a smaller portion, but it's a pretty large portion from where we started. So you're seeing results in commercial based on that. You're seeing results from our corporate T&E business, our fleet business. Those are all already in the system, and there's continuing momentum on those.

But what you're asking is with ACH specifically, are we going to make new inroads in that space in the other non-cardable portion within the next two to three years or five years. I actually don't know how to answer that. Because, as I said, the Vocalink strategy depends a great deal on what way we enter different marketplaces. ACH tends to be, over the years, a very country-by-country business. It has only in a few cases, like Vocalink itself, which has demonstrated the ability to install its capability in more than one country, in fact, in five or six countries. That's a rare exception. Most ACHs are very domestic.

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And therefore, to really get an inroad into the B2B business, you'd first get into the domestic ACH switching opportunity in that country. And that could either happen as an infrastructure play, all of which are in the various stages of RFPs. And if you know how to guess a government-owned RFP process in terms of timing, you can do it better than me because I don't. And we'll see when it comes out.

But the other options, which are more to do with apps and scheme rules and the like, those tend to be on a shorter timeframe than the infrastructure. So we're kind of working our way through all of this. It's very early days. I would hate to give you an estimate. I just know that in the next two or three years, you will see enough proof points to know that Vocalink is a really good asset for our company. That you will see. Whether that transforms our B2B revenue or not, I'm just not willing to make that commitment yet.

A - Warren Kneeshaw {BIO 16549173 <GO>}

Next question, please?

Operator

Your next question comes from Sanjay Sakhrani. Caller, please take your company. Your line is open.

Q - Sanjay Sakhrani {BIO 7390132 <GO>}

Thanks. KBW. Maybe on a related note, Ajay, you mentioned The Clearing House will be going live or has gone live with the real-time ACH. Could you just talk about your understanding of the use cases for that network? And then, when we think about the actual revenue benefit to you, is that already in the run rate because it's a software fee, or are there volume-based revenues as well? Thanks.

A - Ajay Banga {BIO 4676567 <GO>}

Sanjay, The Clearing House hasn't gone live yet. What's gone live is the check imaging and clearing system in the UK. That went live yesterday. The Clearing House is in the process of testing the software that's been put into their system with a couple of the banks. And then they'll roll out as the banks become technically enabled to connect to the fast ACH platform that The Clearing House has built with us.

Your second part of your question about the revenue stream, it's actually a software license. And therefore, it's not as though off the current use of that software as it increases for The Clearing House, that we will make any new revenue each time that that software is clicked upon. That's not what you should factor in. But what could happen is use cases being built on it, which enable us to play more actively in that space. It could be use cases for P2P. It could be use cases for B2B. And eventually, it could be use cases, if it makes economic and business sense, for B2B across border, if it can be connected to other clearinghouses or other ACH switches in other parts of the world. That's kind of what we're doing with them.

The different use cases are all of those, and I think you're going to have to wait and watch how American banks look at the capability of the fast ACH to figure out which one of those satisfies a business case where they're either meeting a need that somebody else is filling right now or they believe that there is a priceable opportunity or a value extension opportunity in that system. And I don't think that those answers are clear yet.

Q - Sanjay Sakhrani {BIO 7390132 <GO>}

Thank you.

Operator

Your next question comes from David Togut. Please state your company. Your line is open.

Q - David M. Togut {BIO 1496355 <GO>}

Thank you. Evercore ISI. Could you comment on the pipeline for new pan-European deals, especially as recent payment routing regulations in Europe open up the playing field versus some of the national payment schemes?

A - Ajay Banga {BIO 4676567 <GO>}

Well, the opening up of the playing field versus the national payment scheme has been happening for a while, not just because of PSD2. Actually, PSD2, the new regulations, are more about how other players outside of the domestic payment schemes, could also enter into the value chain and become players in between the banks and the merchant or in between the banks and the consumer. So it's two quite different things that are going on.

The aspect of tackling the domestic payment scheme, that work is ongoing. And every quarter, actually, we see more and more transactions in most countries. Now, it's not a - as Javier, our European President, is fond of saying that it's an evolution not a revolution, because everything in Europe moves at that pace. And we're seeing improved number of transaction share in every country as far as domestic payment schemes are concerned.

As far as PSD2 is concerned, there's a lot of work doing on - we talked about it at Investor Day a little bit - both in terms of enabling banks and acquirers to be able to meet the challenges that will come about through the new regulations, where essentially they will be responsible to provide both a transparency of the data to other players, but also a safety and security layer that they are going to be beholden to. And we can help them with both of those things.

We can also help them with - and help the merchants - with their transaction thinking over the course of the next couple of years. So we've got a team of people in Europe who we're working with, merchants and banks, ready to roll out ideas how we could be helpful with them and fin-tech players over the next couple of years.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

So, David, Europe's GDV grew 16%. That just doesn't happen by itself all because of the economic environment in Europe. Of course, secular trend drives some of it, but the other one is what Ajay has been talking about: Every quarter we're actually winning deals that's helping this number to continue to grow. And with the second portion on PSD2, as Ajay said, we have a really big team there. There's a lot of opportunity, but it's very early stages yet in terms of going after what kind of help the banks are needing.

A - Ajay Banga {BIO 4676567 <GO>}

Just need to remember that the fact that it's a low-interchange environment will introduce its own element of how quickly PSD2 will enable different forms of acquiring and payments to take strength in Europe. Because if you have a low-interchange environment, the other side of this is there's less money available in the pot for people to build out acceptance and build out alternative payment methodologies in Europe. There's just less.

And so I would treat PSD2 as something that's going to take a few years to really start showing changes. You'll see changes at a high level, rather than real numbers changing, and reform is going to take some years to come. Meanwhile, we're going to keep trying to win as much as we can from domestic businesses and from some of our other more famous global competitors during this period.

Q - David M. Togut {BIO 1496355 <GO>}

Thank you.

A - Warren Kneeshaw {BIO 16549173 <GO>}

Next question please?

Operator

Your next question comes from Tien-Tsin Huang. Please state your company. Your line is open.

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

Thank you. I'm with JPMorgan. Just want to - I guess a lot of talk about security. So was curious, on the Equifax breach, any fallout from that breach? Could you see a change in deal or maybe reissue activity or more demand for security projects? Any color would be great. Thanks.

A - Ajay Banga {BIO 4676567 <GO>}

Tien-Tsin, not yet, not yet. Remember, first of all, the number of cards that got leaked in that time were very few. It's like - I'm trying to remember. I think it's less than 300,000 cards. And you know that compared to the breaches of card information that happened in the past, we're missing many zeros at the end of that in relative terms. So typically, that's where the first level of the activity tends to be.

The issue, as you know, with the Equifax data being out there is really identity fraud over a period of time. And you see some elements of that, but it's difficult to figure out whether that's because of Equifax or that's just part of the way that cyber theft is beginning to become a more noticeable item in our connected Internet of Things world. So I wouldn't jump to any conclusion right now that Equifax breach is leading to new or higher attacks in any way. That's probably not a true statement.

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

Makes sense. Thanks. Congrats on the revenue growth.

A - Ajay Banga {BIO 4676567 <GO>}

Thank you. Just keep using your card, man.

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

Will do, will do.

Operator

Your next question comes from Jason Kupferberg. Please state your company. Your line is open.

Q - Jason Kupferberg {BIO 6867809 <GO>}

Bank of America Merrill Lynch. Thanks for taking the question. So just to start, was curious if we can get a general update on the global e-comm and online business in terms of size and growth. And then, Ajay, any latest thoughts on India? I know they're been moving forward with QR code standards there. Is this going to move the needle for Mastercard, in your opinion, in the next two to three years?

A - Ajay Banga {BIO 4676567 <GO>}

I'm going to let Martina have the pleasure of answering the e-comm line. I'll tell you about India. I was there actually a few weeks ago co-chairing the World Economic Forum. It's pretty interesting. Trying to think where I should start from. I continue to see spend on digital forms of payment, card and wallet, increasing. There's no doubt. Although cash withdrawals are right back where they used to be pre-demonetization. So it's kind of a strange place to be in, considering how much effort has gone into this.

Now, what has happened as the GSTs begun to roll out, and I think that will have a different form of impetus over a period of the next few months on the incentive to use traceable forms of payment rather than non-traceable cash, just because merchants will no longer have the incentive to help a consumer pay less by not paying taxes, because they, in turn, will pay taxes anyway earlier in the chain. So they need to recover the taxes or absorb a hit in their margin, and it's a reasonable quantum of tax to try and absorb that.

So next you see high purchase volume growth. In fact, this quarter, as in other quarters, the number is astronomical. I mean, it's in excess of 70%. It was 100% a few quarters ago.

It's in excess of 70%. But there's negative cash volume growth because of withdrawals from ATMs being down, but less so than they used to be. As I said, cash usage is back. So there's an interesting mix of business changing over there.

I'm generally optimistic about the fact that over the next two, three years, we will continue to see good, strong spend in digital, cards and wallets, in the country because as I said, of the GST. Along with that, there's very high acceptance growth happening. And acceptance terminals are now up to 2.9 million compared to 1.5 million just in September last year. Now, remember, there's 60 million merchants in India if you take the informal sector as well. So 2.9 million is interesting, but there's heck a lot of merchants to go yet.

That's where QR comes, to your first part of your question. The QR code-based acceptance, now that it's been standardized through EMVCo, as you've got what's called Bharat QR, which is rolling out – that, to me, has a real opportunity to change the number of merchants accepting electronic payments because of the cost of the terminal and the cost of maintaining the terminal and the software is gone and been replaced by this relatively cheaper form of starting of accepting.

What's missing right now is the clarity for the acquiring banks and acquiring players on what the merchant discount rate would be for transactions in the country. As of January 1 in 2017, there's actually, if you remember three months last year, 0 MDR as a promotion. That kind of came back to be reinstated, but at a lower rate. And those lower rates are still in effect because the regulator had proposed higher rates, and those are going through various stakeholders. And I think sometime next year in the first quarter or second quarter, you're going to get a policy statement. Once that becomes a policy, acquiring banks are going to know what their revenue model is, and therefore what their risk-reward equation should be in building out acquiring using QR.

Long answer, but generally, what I'm trying to tell you is I think it's headed in the right direction. I think GST will provide an impetus. I think you will continue to see growth in all kinds of business and digital payments in India. And I think QR, you should begin to see more impetus in it next year. Now, having said that, 15 issuers and 22 acquirers are already on with QR payments. But I just think there's a significant growth opportunity that is yet to come.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

From an e-commerce perspective, your other part of the question, worldwide, as you know, e-commerce is about 10% of retail payments. And by the way, that was around 8% just three years ago or so. So clearly, what is happening in the gig economy with Uber and et cetera, there's a lot of Airbnb. There's a lot of growth in terms of e-commerce side. In terms of our switched volumes, we have about a quarter of those on the e-commerce side.

And then that growth at a very healthy 20%-plus pace. So it's good. It's additive, and we're focusing on it. As you can see, with some of the remarks that Ajay has been doing, what we're doing with Uber in Asia Pacific as well as what we're doing with Netflix in terms of making sure that people can use their cards easier going forward as they're – get

upgraded on their cards or they get replacement cards. All of that will continue to benefit the e-commerce growth.

Q - Jason Kupferberg {BIO 6867809 <GO>}

Thanks for all the commentary.

Operator

Your next question comes from Lisa Ellis with Bernstein. Your line is open.

Q - Lisa Ellis {BIO 18884048 <GO>}

Hi, good morning, guys. Follow-up question on Europe. I guess, part one, just looking at Europe, where the purchase volumes are up a couple of points over the last couple of quarters and transaction volumes also up 4, 5 points over the last couple of quarters. First part of the question: Martina, can you just dimensionalize for us how much of that is due to the shift or swap from Maestro cards into Mastercard cards? Because it looks like Maestro cards are down about 5%, so just trying to clarify how much of that is just a reporting thing versus underlying acceleration.

And then, I guess, second question, how is debit - it looks like debit is very strong in the region. So how is - can you just - maybe this is an Ajay question - articulate the how you're competing debit in these regions where you're competing aggressively against a pretty well-established bank transfer bank transfer network, what the value proposition of debit is there? Thanks.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

So, Lisa, on your first part of the question, first of all, the economic environment, secular trends as well as some of the wins that I have called out in a number of countries like Russia and Sweden. Actually, we had some better performance in Turkey and Italy. That wasn't necessarily related to wins, but that was better performance. That all drives Europe.

From a Maestro to a Mastercard slip, those are actually very important. Maestro cards, as you know, are mostly used in the cross-border context and not as much used in the domestic context, because obviously, they are co-batched with a domestic scheme on it. When those cards get flipped to a Mastercard, those cards make actually a lot more money for us from a revenue point of view. So it's not just a technical, you have Maestro cards going away and Mastercards showing up. These are real revenue-generating activities, because a person now can use the card not only out over the cross-border side, but also domestically, and they earn the points or the rewards and get on anything that might be with a card.

A - Ajay Banga {BIO 4676567 <GO>}

And, Lisa, back to the other question about debit growth in a region like that. So there are two or three things. First of all, there is our debit growth within the volume that's already in debit. And I've been saying this stuff for five, six years. They're growing share in Europe.

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And the facts are the facts of the numbers. If you look at Nielsen reports, they'll show that to you as well. That's the first one.

The second part is a really interesting question, which is how do you compete with these bank-connected networks which exist. Germany, a number of consumers, even like Martina, who are confused Germans, they go around actually -

A - Martina Hund-Mejean {BIO 3677291 <GO>}

Converted Mastercard user.

A - Ajay Banga {BIO 4676567 <GO>}

Yeah. Converted Mastercard user. They actually do give their bank account data to merchants to be able to do a direct transfer, which I find fascinating. Having lived in Brussels for years, I know that I used to even make payments to my gardener and my vendors with some direct bank transfers.

But there are three or four things that allow you to grow versus that as well. The first one is technology in itself. Just bank-to-bank transfer system is clunky and old, and it's run by typically associations of banks with limited ability to invest, just as the domestic payment schemes have limited ability to invest with new technology. What do I mean by that? Technology on safety and security. Technology on loyalty, technology on things that enable them to be competitive to what we could do with card and other forms of digital payments. So I think that's the first thing that enables us to fight in a number of these markets. And including in places like the Nordics, which are actually relatively high accepters of new technology.

The second part is acceptance. I mean, debit enablement through bank clearing systems, as I said, has tended to be a localized business. The moment you want to go cross-border or even expand within the local domestic acceptance, a network tends to be a more interesting differentiator. So it's really a question about the network rather than it is a question about debit cards versus domestic payment systems. You know what I mean?

Q - Lisa Ellis {BIO 18884048 <GO>}

Yes, terrific. Thank you. Thanks, Martina, to you too. Thanks.

Operator

Your next question comes from Dan Perlin. Please state your company. Your line is open.

Q - Dan Perlin {BIO 1758057 <GO>}

Thanks, RBC. So you talked about the global expansion partnership with PayPal. And I'm just curious, at this point in the stage - and you talked about a bunch of different areas of integration - have you seen a discernible difference in terms of volumes that are actually being driven by PayPal onto your network? And if so, are you at a point now where there's threshold payments or incentive fees that would actually get paid back to them? Thanks.

A - Ajay Banga {BIO 4676567 <GO>}

So remember there are two key elements of our partnership with them. The elements of the co-brands and so on, yes, absolutely, we see volume from the co-brands, but we've had that relationship with them, in some cases, for quite a while. They've been renewed and they're growing. PayPal is doing well in the co-brand space. So those we see, and that's great. We've got some commercial and prepaid deals with them in Europe. Those we see. That's great.

There's two new things which you're referring to. One is Masterpass acceptance as Braintree goes out and signs up merchants. We had to first integrate our Masterpass capability into Braintree. In the U.S., that has happened. And as of the last few months, they've begun to go out and sign up merchants, whom they're signing up for Braintree. They're also putting Masterpass into it. We're beginning to see the first few of those merchants come online. Obviously, that work has to be done in a number of the regions. So you should see that over the next six to nine months, maybe sometime during 2018 is when that Braintree-Masterpass integration across the world will happen in a form that will give us some scale on growing acceptance.

The part about being an equal player, again, it rolled out in the U.S. about a couple of - two, three months ago. And if you try and enroll on a PayPal in the U.S. today, you will see that there's a very different offering methodology compared to what used to be there a year ago, when PayPal used to prompt and push you towards giving your bank account details. That's no longer happening. We're seeing the natural benefit of some of that in our numbers. None of it is setting the house on fire yet, but it's good.

Q - Dan Perlin {BIO 1758057 <GO>}

Thank you.

A - Warren Kneeshaw {BIO 16549173 <GO>}

Thank you. Operator, I think we have time for one more question.

Operator

Thank you. Your next question is from Craig Maurer from Autonomous Research. Your line is open.

Q - Craig J. Maurer {BIO 4162139 <GO>}

Thanks. Thanks for taking the question. Two questions, actually, the first on cross-border. You had discussed China being strong. Is this because you're taking share in the single network reissuance from your competitors? And secondly, regarding Brazil, where are you on regulatory approval of the Itaú processing deal? Thanks.

A - Martina Hund-Mejean {BIO 3677291 <GO>}

Hey, Craig. On China, I think it's a mix of things. First of all, the single issuance is going well, and they're really expanding the number of cards that they're having out there in the

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market, and that obviously adds something. But also relatively recently, a number of banks went back to dual grant issuing and continued with that. You might remember that late last year, earlier this year, there was a bit of a hiatus on that, given that there was rough clarity from a regulatory point of view, and that opened up again, but only for a number of issuers. And that certainly is a benefit, given that many of these dual-branded cards are top of wallet.

A - Ajay Banga {BIO 4676567 <GO>}

And our share in the dual-branded card issuance over the last three or four years was much larger. Every time a new dual brand got approved, we were a much larger of share within that. That's kind of baked in that number.

Your question on Brazil, that deal is still in regulatory limbo. It hasn't yet - remember, when we did the Itaú flip and win, one, we won most of their new card issuance as well as flipping the past book. But we also agreed to do with them this domestic payment network to compete with other domestic payment networks. What's happened is the regulator there, (58:08), about a couple of months back, has begun to change the rules for the other networks in such a way that the competitive advantage of launching our own domestic payment network with Itaú is no longer as strong as it would've been if it kept the debenture rules in place. That's why it's in regulatory limbo. Nothing new is happening on that as of now.

Q - Craig J. Maurer {BIO 4162139 <GO>}

Okay, thank you so much.

A - Warren Kneeshaw {BIO 16549173 <GO>}

Okay. Ajay, do you have any final comments?

A - Ajay Banga {BIO 4676567 <GO>}

That's Warren reminding me that I've got to read our cards. Okay. Got it. Thanks for all your question, and I'm going to wrap up with a couple of closing thoughts. We continue to deliver strong financial performance while investing in our business for the long term. That investment in our business is a core part of the way Martina and I run our budget cycle and our strategic planning, and that is something we're not willing to sacrifice while continuing to grow revenue the right way. We're off a good start in each of our acquisitions. Integration efforts are well underway.

We're very focused on safety and security. You heard me talk a little bit about the early detection system and adding products like that to our expanding set of customer tools to enhance our ability and those of our customers to make sure that this ecosystem is safe, and safe and simple ways to pay exist. Most of this is done through incorporating technology and artificial intelligence into our systems and our data.

We're executing well on our strategy, which is continuing to drive sustained levels of strong revenue growth. And we appreciate your continued support of the company, and

thank you very much for joining us today.

Operator

And, ladies and gentlemen, this concludes today's conference call. You may now disconnect.

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