

Q4 2018 Earnings Call

Company Participants

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

Other Participants

- Craig Jared Maurer, Analyst
- Darrin Peller, Analyst
- Eric Wasserstrom, Analyst
- Harshita Rawat, Analyst
- James Eric Friedman, Analyst
- James Schneider, Analyst
- Lisa Ellis, Analyst
- Moshe Ari Orenbuch, Analyst
- Ramsey El-Assal, Analyst
- Tien-Tsin Huang, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Heidi, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mastercard Q4 Full Year 2018 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

Thank you. Warren Kneeshaw, Head of Investor Relations, you may begin your conference.

Warren Kneeshaw {BIO 16549173 <GO>}

Thank you, Heidi. Good morning, everyone and thank you for joining us for our fourth quarter 2018 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 for questions. 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 unless otherwise noted. Both the release and the slide deck include reconciliations of non-GAAP measures to their GAAP equivalents. Please note that due to our decision to deconsolidate our Venezuelan entity starting at the beginning of 2018, we've been providing additional information regarding our switched transaction and card growth rates. The adjusted growth rates eliminate Venezuelan switched transactions and card counts from prior periods.

In addition, starting this quarter, we are providing further adjusted growth rates for switched transactions and adjusted growth rates for cross-border volume normalized for the effects of differing switching days between periods. These adjustments have been made to current and prior quarters. This information is being provided so that you can better understand the underlying growth rates of our operating metrics. Our comments on the call today will be on the basis of these adjusted growth rates.

A couple of other comments. As many of you are aware, we recently announced an agreement on the terms of recommended offer to buy Earthport. We will not be at liberty to further comment on this potential transaction as it is regulated by the Takeover Panel in the UK. I would also like to announce that we are planning to hold our next investment community meeting on September 12, 2019. We initially planned to hold this event in Q2, but have settled on a September date as a result of some scheduling issues.

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 the earnings release and in our recent SEC filings. A replay of this call will be posted on our website for 30 days.

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

Ajaypal S. Banga {BIO 4676567 <GO>}

Thank you, Warren, and good morning, everybody. So we had a very strong end to the year bringing 2018 to a record close. For the year, revenue was up 20%, EPS up 41%, and these are both on a currency-neutral basis and excluding special items. If you exclude the impact of accounting changes, acquisitions and the \$100 million contribution to what we are now referring to as the Mastercard Impact Fund that affect year-over-year growth comparisons, so basically apples-to-apples, our underlying net revenue growth was up 15% and operating income was up 21%.

These results essentially reflect broad-based growth across each of our regions, and I think are a clear reflection of our focus on execution. We continue to invest in the business

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for the long term. I believe that we are very well-positioned to drive strong growth in the future, and Martina will describe this in much more detail when she lays out our new multiyear performance objectives.

Turning to the macroeconomic environment, we continue to see solid overall growth and expect this to continue in 2019, although with some moderation. Having said this, like others, we're keeping a close eye on a number of items; increased trade tensions, rising interest rates and other economic and political factors that could slow growth over the longer term.

In the U.S., economic growth remains positive with low unemployment and, overall, still healthy consumer confidence. Our SpendingPulse estimates for Q4 show retail sales remain strong, up 4.8% versus a year ago same period ex-auto, ex-gas.

In Europe, we continue to see moderate growth with UK spending holding up reasonably well, again, according to our SpendingPulse estimate, with year-over-year retail sales up 3.5% in Q4 ex auto, gas and restaurants, despite the debate around Brexit. We have, however, seen some recent declines in consumer confidence in countries such as France, Spain and the Netherlands.

In Latin America, we're watching to see how the economic and fiscal policies develop in both Brazil and Mexico now that the elections are behind us. We are seeing some positive consumer and business confidence indicators in Brazil in particular.

We're monitoring a few potential headwinds in Asia including trade negotiations and the talked about slowdown in the Chinese economy. As we don't participate domestically in China, this has a limited impact to us directly. But given the size of the Chinese economy, it does impact the global economic picture.

Against this backdrop, we just continue to see a strong secular shift to electronic forms of payment. We are driving healthy double-digit volume and transaction growth for Mastercard across most of our markets. And as I said earlier, these results are a function of us successfully executing against our strategy. We are growing our core products, we're diversifying our customer base, and we're building out new capabilities, and I'm just going to give you a few examples.

First, we're driving growth in the core with new wins like Westpac Bank, one of the largest banks in Australia. They will become an exclusive Mastercard issuer for all their Westpac branded consumer credit and business card portfolios. And we retain exclusivity across their debit business.

Westpac will also leverage several of our value-added services such as advisors and loyalty platforms. In addition, we renewed our agreement in New Zealand securing the majority of Westpac's credit and debit portfolios and flipping their loyalty platform.

We've also executed pre-renewals with leading banks across several markets. So, we signed a long-term deal with Crédit Agricole, the largest bank in France, which includes new consumer and commercial issuance beyond our existing base. And as part of that deal, they will also use a range of our data analytics platforms including Applied Predictive Technologies, APT, to help optimize their customer acquisition and retention efforts.

In the Netherlands, we renewed our partnership with Rabobank, enabling us to maintain a leading market share position in credit and debit in that country. And in China, we will be the exclusive international scheme partner for ICBC's Global Travel Plus Card (08:12).

On the co-brand front, we signed a long-term extension with WestJet in Canada, won a new co-brand program with Square which will enable Square's sellers to access their receivables through a Mastercard debit card. We were selected as the partner for JetBlue's programs across the 19 Caribbean markets, which, together with our U.S. co-brand, make us the partner on each of JetBlue's co-brands around the world.

I'm also pleased to report that our major U.S. co-brand conversions have been successfully launched. L.L.Bean and Kroger are fully converted, and Cabela's, which are all contactless card by the way, is scheduled to be completed by the end of this quarter.

In addition to building co-brand relationships with merchants, we're also diversifying our customer base through partnerships with governments. And one recent example is in Mexico with Bansefi, the commercial banking arm of the Mexican government where we have just been chosen to help distribute a wide range of social benefit disbursements to citizens across the country. This exclusive program will involve the issuance of approximately 20 million new debit cards that will be used to receive and spend social benefit payments.

So, turning to B2B, we continue to see momentum in our core commercial card business. We're developing a new fleet co-brand product with U.S. Bank that enables greater customer choice by combining U.S. Bank's proprietary closed-loop fleet product with our broad open loop acceptance footprint.

We're also making progress in the accounts payable space, taking the Mastercard B2B Hub model international through a new partnership, which I think is very exciting, with MYOB in Australia and New Zealand. MYOB provides an invoice capture facility, supplier enablement payments and payroll solutions, so small and big sized businesses, and brings the local market expertise and customer relationships that are critical to success for these kinds of businesses in the B2B space. The initial launch will focus on invoice payments and payroll solutions distributed to MYOB's existing customers.

In the U.S., we're expanding virtual card distribution through an exclusive partnership with Bill.com and Comdata. This partnership integrates our virtual cards within Bill.com's automated accounts payable solutions and that should enable us to reach their 60,000 customers who, by the way, currently make over \$60 billion in annual payments. The addition of these merchant cards creates a safe, seamless and secure way for businesses

to be paid and provides the data needed to help merchants evenly match payments with receivables.

On the digital front, we're driving the adoption of new capabilities to improve the customer experience and enhance safety and security across all transaction types and channels. So a few examples; in the U.S., contactless momentum continues to grow on both issuing and acceptance sides. We've received commitments from issuers representing approximately two-thirds of our total U.S. consumer volume to issue contactless cards within the next two years. This includes Citi, Capital One, KeyBanc, Santander, HSBC and others. We're also working with leading processors like FIS to bring contactless to smaller issuers and to credit unions.

On the acceptance side, large retailers like Target and CVS have announced that they will now accept contactless payments. And in total today, over half of the U.S. card-present transactions are happening at contactless-enabled merchant locations.

We continue to scale our merchant tokenization service with partners who have recurring bill pay models, including large telcos like AT&T and insurance companies such as Liberty Mutual. And we are supporting merchants and acquirers via Payment Gateway Services, which provides the white-labeled technology platform for payment processing, for fraud prevention and for digital payment acceptance.

Actually, JPMorgan Chase has selected Mastercard Gateway Services to enhance its global connectivity and support of alternative payments, as they continue to expand global digital payment solutions for their merchants.

And finally, we're partnering with digital players to offer payment capabilities through new devices and channels. And for instance, in Poland, we just recently announced a strategic alliance with BLIK, a mobile payment system provider. This integrates a virtual tokenized Mastercard debit card, so BLIK users can make contactless payments at any Mastercard acceptance location.

In South Africa, Bank Zero, which is a new bank with no physical branches and app only value prop, will be issuing debit Mastercard in 2019. And in Taiwan, E. SUN Bank will launch a Mastercard co-brand with Pi wallet, which is a leading mobile wallet provider in that country.

So, with all of those updates, let me now turn the call over to Martina for an update on our financial results, operational metrics and going forward estimations of growth. Martina?

Martina Hund-Mejean {BIO 3677291 <GO>}

Thanks, Ajay, and good morning, everyone. Turning to page 3, you will see that we delivered another very strong quarter to end the year. Here are few highlights on a currency-neutral basis, excluding special items related to certain legal and tax matters.

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Net revenue grew 17% in line with our expectations and closing out a great year of growth. This includes a 5 ppt benefit from the new revenue recognition rules. Excluding this benefit, revenue growth was 12%. Operating income grew by 21%, including a 7 ppt benefit due to the new revenue recognition rules.

Net income was up 36%, reflecting strong operating results and the impact of the U.S. tax reform, which contributed approximately 12 ppt to this net income growth. And EPS was \$1.55, up by 40% year-over-year, with share repurchases contributing \$0.03 per share. During the quarter, we repurchased about \$888 million worth of stock and an additional \$773 million through January 30, 2019.

Let me turn to page 4, where you can see the operational metrics for the fourth quarter. Worldwide gross dollar volume or GDV growth was 14% on a local currency basis, up 1 ppt from last quarter. We saw solid double-digit growth across all regions. U.S. GDV grew 10%, up approximately 1 ppt from last quarter, with strength in consumer credit driven by the implementation of recent deal wins. And outside of the U.S., volume growth was 16%, slightly up from last quarter.

Cross-border volume grew at 17% on a local currency basis, in line with expectations and driven by double-digit growth in all regions except for Latin America. Q4 cross-border growth was slightly lower than the growth you saw in Q3, primarily due to the high volume of cryptocurrency wallet funding in Q4 of 2017.

Turning to page 5, switched transactions continued to show strong growth at 17% globally. We saw healthy growth in switched transactions across all regions led by Europe and the U.S. In addition, global card growth was 7% and, globally, there are 2.5 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. The 17% net revenue increase was primarily driven by strong volume and transaction growth as well as growth in our services offerings, partially offset by rebates and incentives. The new revenue recognition rules contributed 5 ppt to the growth rate. As I said before, excluding this, net revenue growth was 12%.

Looking quickly at the individual revenue line items, domestic assessments grew 18%, while worldwide GDV grew 14%, and the difference is mainly due to the new revenue recognition rules with some pricing offset by mix.

Cross-border volume fees grew 16%, while cross-border volume grew 17%. The 1 ppt difference is mainly due to higher intra-Europe growth. Transaction processing fees grew 17%, in line with the 17% growth that we saw in switched transactions. And finally, other revenues were particularly strong this quarter, up 19% driven by increases in our advisors and safety and security services.

Moving on to page 7, you can see that, on a currency-neutral basis and excluding special items, total operating expenses increased 14%, which includes a 2 ppt increase related to

the new revenue recognition rules and acquisitions. The remaining 12% was primarily related to the company's continued investments and strategic initiatives.

Turning to slide 8, let me first discuss what we have seen through the first four weeks of January. The numbers through January 28 are as follows. Starting with switched volume, we saw global growth of 15%, similar to the fourth quarter. In the U.S., our switched volume grew 12%, a sequential increase of 1 ppt with strength in both credit and debit. Switched volume outside the U.S. grew 17%, and that's down 2 ppt from the fourth quarter, but still strong at slightly slower growth in Europe. And globally, switched transaction growth was 17%, similar to the fourth quarter.

With respect to cross-border, our volumes grew 12% globally, down 5 ppt sequentially. So let me put this 12% into perspective. In 2019, we will face difficult year-over-year comps due to the strong cross-border growth we saw in 2018. This is especially true for January as we are lapping significant cryptocurrency wallet funding and particularly strong European activity in part due to the timing of certain holidays a year ago. This has been further impacted by some poor weather conditions in Europe this year. For the year, we expect cross-border growth will be about mid-teens and this is contemplated in our thoughts for revenue growth for the year.

I'm going to switch gears a little bit and talk about our long-term performance objectives, and we will start here on slide 9: how we did against our 2016 to 2018 performance objective which was set out on a currency-neutral basis excluding special items and acquisitions made during the period and were built off an earnings base that excluded certain one-time tax benefits recognized in 2015. So, recall that we actually updated our estimates last February for the impact of the new revenue recognition rules and the U.S. tax reform.

So, as you can see here on this slide, we delivered very strong results over this period. Net revenue grew at a CAGR of 15%, slightly ahead of our most recent estimate. We achieved our annual margin commitment and delivered 28% compound annual EPS growth over the period, which includes a 3-percentage point benefit due to U.S. tax reform.

So now I'm turning to slide 10 to lay out our new performance objective, again, for a three-year period, so from 2019 to 2021. And as usual, all the numbers I'm going to give you will be on a currency-neutral basis excluding future acquisitions and special items.

So based on the excellent performance over the last few years, we believe that we are very well positioned to continue to: one, grow our core consumer and commercial business to expanded solutions and market share growth, enhance our digital capabilities to enable more online and mobile transactions in a seamless and secure way, and grow our overall acceptance footprint.

Two, enhance our B2B capabilities with new solutions like the Mastercard B2B Hub and Mastercard Track. At the same time, we will continue to lay the groundwork for future growth in Faster Payments by investment in infrastructure, applications and value-added services. And finally, further expand our capabilities in services such as safety and security

solutions, data analytics and loyalty, which together we expect to grow faster than the core business.

As a result, we believe that we can deliver a low-teens compound annual net revenue growth rate over the next three years. This is based on a PCE growth of approximately 4% to 5% globally and, therefore, does not assume a significant economic downturn. These objectives also exclude progress on our goal of entering the domestic payment market in China, and reflect minimal net pricing over the period.

In terms of our operating margin objective, we continue to focus on top and bottom line growth by investing for the long term. As you all know, we are not managing to a particular margin outcome. But for those of you who would like to see some assurance that we continue to be prudent with our investments and expenses, we are keeping the minimum 50% annual operating margin threshold as part of our long-term performance objectives.

So, consistent with the revenue profile I just described and based on the 2018 non-GAAP EPS number of \$6.49, which excludes special charges, we expect a high-teens earnings per share CAGR over the 2019 to 2021 period. This assumes a tax rate of 19% to 20% and includes the impact of continued share repurchases.

So now let me give you a little bit more for our thoughts on 2019, and you can see that on slide 11. Again, I will describe those on a currency-neutral basis and exclude special items and future acquisitions. We anticipate continued strong growth in our business in 2019, but have assumed a slight moderation in the overall economic environment from 2018.

So, for net revenue, we expect to grow at a low-teens rate. In the first quarter, growth will be about 2 ppt lower than the annual estimate, primarily due to the difficult comps in the year-ago quarter. You may recall that, in Q1 last year, we had a relatively strong cross-border and services revenues, and relatively low rebates and incentives. And as this normalizes through the year and we implement business wins, we expect that the currency-neutral net revenue growth rate will increase in the balance of the year.

Foreign exchange is expected to be about a 2 ppt headwind to annual growth and given the current strength in the U.S. dollar, this will be a much larger headwind in the first quarter at about 5 ppt due to the profile of the year-ago exchange rates.

On operating expenses, we expect growth for the year at the high-end of the high-single digit range as we continue to invest in expanding our digital solutions, safety and security products, data analytics, geographic expansion and platforms to address new payment flows.

In the first quarter, we also intend to fund the Mastercard Impact Fund at a similar level to what we contributed last year in Q1. Based on current rates, we expect foreign exchange to have a 1 ppt tailwind to operating expenses for the year and a 2 ppt tailwind for the quarter.

From a sensitivity standpoint, a \$0.01 change in the value of the U.S. dollar relative to the euro is expected to have just under a \$50 million annual impact to revenue, considering both transactional and translational effects. Similarly, a \$0.01 change in the value of the U.S. dollar relative to the Brazilian real is expected to have an approximately \$25 million annual impact to revenue. We estimate the tax rate to be approximately 19% to 20% for the year.

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

Warren Kneeshaw {BIO 16549173 <GO>}

Thank you, Martina. Heidi, we're now ready for the question-and-answer session.

Q&A

Operator

Thank you. And your first question comes from the line of Craig Maurer with Autonomous Research. Please go ahead.

Q - Craig Jared Maurer {BIO 4162139 <GO>}

Hi. Thanks. Two questions for you. First, versus what your main competitor said last night, your commentary on the global outlook seems far more sanguine. Is this a reflection of generally Mastercard's progress in taking share globally and how that's informing your view of the year? And secondly, to what degree should we expect progress in VocaLink this year and progress in real-time ACH payments across geographies? Thanks.

A - Ajaypal S. Banga {BIO 4676567 <GO>}

Okay. I think the first part is a combination of two or three things. One of which is, yes, we've been growing share for the last few years and that gives us some degree of a better leg to stand on. But, remember, we've also been diversifying our revenues with more legs to the revenue stool, so to say, which includes services. And as Martina told you, we expect services revenue to grow faster than our core payments revenue. And so we do have a sense in our business of our numbers. I cannot compare those from what competitors feel. Remember, I'm talking about ours as a vision of our company. And I feel relatively good about those numbers.

The part about the world economy as a whole, look, it's based on assessments of travel and knowledge and research and data. And my sense is that our worldwide economic situation is still in a relatively good place even though we're reaching the 10th year of a global expansion. And will that change over the next year or two? Who knows? Will it change someday? For sure. Just I don't think that 2019 is a year in which you will see more than some moderation. That's our current assumption over 2018. That moderation is built into Martina's commentary about the way we think about our performance in 2019. So that's the way we've put our parts together.

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The part about VocaLink and about Fast ACH, we are - my sense is, first of all, in the UK, VocaLink's position and business and its relationships with all the contracts we have has received good support and extensions. So that's a good thing. In markets outside software has been implemented in the U.S. and is rolling out. It's there in a number of markets in Thailand and parts of the Nordics.

We believe that there are tons of opportunities coming along for infrastructure in a number of countries. Now, once the RFP is won it takes years to actually put those switches up on the ground. There's also opportunities to partner with domestic switches to improve their capabilities, some of which you will see us talk about over the next six to nine months. But you should remember that, to me, Faster Payments is not a sprint. Like digital payments and acceptance, these are marathons, and we're willing to play the marathon.

Q - Craig Jared Maurer {BIO 4162139 <GO>}

Thank you.

Operator

Your next question comes from the line of Moshe Orenbuch from Credit Suisse. Please go ahead.

Q - Moshe Ari Orenbuch {BIO 1497419 <GO>}

Great. Thanks. Maybe we could kind of talk about the outlook in the U.S. You alluded to some wins and I think Cabela's was certainly one of them. Are there others that we would see during 2019 that are going to be converted? And how do you think about the underlying situation? Is there likely an impact from what's going on with tax refunds in terms of either amounts or timing of consumer spending?

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

We don't really see a very significant change in terms of what we see in our numbers from the U.S. When you look at the GDV growth in the United States, in fact, we had a little bit of a higher GDV growth versus Q3 that is predominantly driven because of the conversions and the wins that we had. We continue to see some of that for the rest of 2019. And even when you split that out, we believe that the U.S. is actually still performing relatively well.

We also see actually relatively good cross-border trends from people traveling from the U.S. to other countries. We saw a very, very small decline from other countries traveling into the U.S. given the stronger U.S. dollar, but it was a relatively small decline from growth rates. So it's still growing, but it was just a little bit of a smaller growth rate. So, we feel relatively good.

As you heard what I said in my prepared remarks as well as what Ajay reinforced, 2019, in our numbers, we put a little bit of a moderation from a personal consumption expenditure in there. Personal consumption expenditure worldwide last year was a little over 5%, like

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5.3%, 5.4%. And you can see that we put a little bit of a lower number for our 2019 numbers also for our three-year long-term performance outlook in there because, at some point in time, you do have to expect a bit of a downturn.

Q - Moshe Ari Orenbuch {BIO 1497419 <GO>}

Thanks very much.

Operator

Your next question comes from the line of Ramsey El-Assal with Barclays. Please go ahead.

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

Hi. Thanks for taking my question, guys. You mentioned in guidance that your three-year CAGR does not – includes minimal pricing. I guess just very generally speaking, how would you characterize your ability to take price versus the last three-year cycle or even prior to that?

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

So, Ramsey, we really have not made any significant changes on the philosophy of how we do pricing. Pricing is value-added. The customer has to feel that they would like to have that product and that service and that product and that service brings value-add to the company, to the customer. And therefore, we are getting compensated for it. And we really have not changed that in any shape or form.

And as part of that of course, from time to time, we are able to make some price adjustments. But believe me, these are not only up price adjustments, some are also actually down price adjustments. And that's what we do from a list price (34:51) point of view. We do it in many countries around the world; some is regional pricing.

In addition to that, you have to factor in, of course, deal pricing. And this is a competitive situation. As you know, it gets more and more competitive as you're talking about larger clients. Larger clients are more demanding than some very smaller clients. And so you have to be responsive to that. And so, our comment about minimal pricing includes really both of those components; list price and the changes that we make from time to time, as well as deal pricing.

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

Thanks.

Operator

And your next question comes from the line of Tien-Tsin Huang with JPMorgan. Please go ahead.

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

Hi. Thanks. Good morning. I just want to expand on Craig and Ramsey's question in looking at the next three years versus the past three years. I'm curious if you see a difference in where the growth is actually coming from, because it feels like you have more contribution from fin techs and net new logo wins. Is that fair? And does your cycle guidance include any meaningful contribution from the new payment flows that you've been investing a bunch in?

A - Ajaypal S. Banga {BIO 4676567 <GO>}

Yeah, Tien-Tsin, it includes all those. I'd say, as Martina said, clearly, we expect our diversified revenues from services from these new businesses to give us a higher growth rate than what we would get from our core payments over the coming three years. And that's what you would expect considering they're growing off, one, a smaller base, and two, we're really getting into our stride with some of those which we've been investing in for three, four, five years.

There are others where the investment is one and two years old, and those probably will only show results, hopefully, maybe towards the latter part of this next three-year cycle or maybe even in the next three-year cycle after that. And that's kind of the marathon comment that I was making in response to Craig. So, it's a mix of stuff, but you should expect us to continue to grow our services revenue at a faster rate than our core payments revenue.

Within our core payments, clearly, we see growth and secular movement to electronic forms of commerce helps and share wins help, and a broader and expanded platform of products helps, so does acceptance and so does digitization. So it's a mix of things that are built into growing the core, diversifying our client base, but remember that building new services will give us more than the other two growth rates over the next three years.

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

Yeah. And just to add to that, on the B2B side of course, that is also adding something to the bottom line, and that's where we're looking at it in two different parts. One, our commercial business that we have today, which is really our core commercial business, which is more card-based, that is continuing to grow. Actually, we're seeing very good growth rates in that, but in addition to that, all the B2B verticals that we're building out, both from a domestic and from a cross-border point of view such as the B2B Hub, such as Mastercard Track. And again, as Ajay said, we think that, by the end of the period, you are going to see some added numbers because of that.

A - Ajaypal S. Banga {BIO 4676567 <GO>}

That's why, Tien-Tsin, I was talking about being excited about the MYOB business in Australia. I was just in Australia last week, and it's a really interesting effort to take the B2B Hub outside of the U.S. And that's early days. That's one of those where we're in the early stage of investing.

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

That's great. Thanks for that. Good result and thanks for the FX sensitivity, Martina, as well. Appreciate it.

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

(38:43). Next question.

Operator

Your next question comes from the line of Lisa Ellis with MoffettNathanson. Please go ahead.

Q - Lisa Ellis {BIO 18884048 <GO>}

Hi. Good morning, guys. Nice quarter. My question is related to the longer term trends around cross-border. I was just looking back, and back in, I guess, fiscal 2016, your overall cross-border volume growth on an FX-neutral basis was around 12%, more or less in line with purchase volumes, but then it upticked in 2017 to about 15%, upticked again in 2018 to more like 18%.

And I know you said it's going to moderate a little bit, but still be strong in 2019. Can you just - putting aside the sort of quarterly gyrations, can you just talk about that evolution over a multiyear period? Like what's driving that sustained outperformance? I think, Martina, you mentioned before that you've kind of got an internal team focused on it. Can you just give a little bit more color there to give us a sense for where that's headed over the longer term?

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

Yeah. We really have a multifaceted effort really kind of like - we're running this like a business in terms of what we're doing from a cross-border focus point of view. And you're seeing the fruits of the labor really coming through, even though I have to tell you, 2019, where we have a 19% cross-border growth, as we had said before, that was extraordinary and you shouldn't expect that to repeat itself...

A - Ajaypal S. Banga {BIO 4676567 <GO>}

2018.

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

In 2018, so in...

A - Ajaypal S. Banga {BIO 4676567 <GO>}

We're already in 2019 mentally, but we're still talking 2018.

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

So, in 2019, that's why I guided you guys more to around a mid-teens rate. So, all of the work that we have been doing, obviously, it all starts on what kind of portfolios you're going after, right? What kind of clients are you working with? What kind of portfolios are you getting from the clients?

But then, secondly, once you have the portfolios, you have to do very particular things in order to get cross-border growth going in terms of how people are using that particular product, how you make sure that people know that this is a fantastic product to use, that if you do certain things you actually get the best foreign exchange rates which Mastercard can give. So there are many, many different facets which allow us to work. And by the way, this comes off our advisors group in a very big way with the clients in terms of optimizing those kinds of portfolios. And we have a very honed skill in order to be able to do that.

In addition to that, when you look at the various verticals, so what I talk mostly about right now is the consumer and the commercial portfolios where travelers are actually using the cards, where it's being used in the e-commerce space. As you know, we have also focused, for many years now, really on the virtual card product that is being used by a number of our clients also in the sense of a cross-border transaction. And that has made a fairly significant difference over those years.

A - Ajaypal S. Banga {BIO 4676567 <GO>}

Lisa, the only thing I'd add to you is, put an envelope around this and start with the thinking of cross-border is both determined by the level of travel and tourism on the one hand at a consumer level, combined with corporate travel and commercial travel at a commercial level, combined with cross-border e-commerce. When you look at all three together, you get what the market is growing at in a secular way.

How much you extract from that secular growth is the effort that our team tries to put in using analytics and data and targeted offers of the type that Martina is referring to. And then the third part of it is, if you have the right portfolios, you can get a little bit more out of it. And I think we've got a little bit of all of those working, some as tailwinds, some as headwinds. I'm pretty certain that most people, most companies in this space would try and do things of the type we are talking about. This is not rocket science. It's a question of disciplined execution.

Q - Lisa Ellis {BIO 18884048 <GO>}

Terrific. Thank you. Thanks for the color.

Operator

And your next question comes from the line of James Friedman with Susquehanna. Please go ahead.

Q - James Eric Friedman {BIO 20091873 <GO>}

Hi. Thanks. It's Jamie. I just want to ask, with regard to the cycle guidance, I realize that services is contemplated to grow in excess to the corporate average. Is commercial writ

large, including B2B, is that also contemplated to grow faster than corporate average?
Thank you.

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

Jamie, we're really not providing any individual guidance on this. So, most of the commercial portfolio is part of the core and, as you just heard us say, the new stuff in B2B, we are building out as we speak. So that's the B2B Hub, that is Mastercard Track, and a number of things that we're doing in the cross-border space.

Q - James Eric Friedman {BIO 20091873 <GO>}

Okay, got it. Thank you.

Operator

And your next question comes from the line of Eric Wasserstrom with UBS. Please go ahead.

Q - Eric Wasserstrom {BIO 3626772 <GO>}

Thanks very much. Two questions, please. The first, Martina, just on the - going back to the three-year performance objectives, just intuitively, the delta between the low-teens on revenue and the high-teens on EPS, if we extrapolate the current level of share repurchases, still implies something around 100 basis points of annual operating margin improvement. So, can you just maybe touch on that issue?

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

So, listen, as I said in my prepared remarks, we really do not run the company by just expanding operating margin. We run the company for top line growth and bottom line growth. And depending how you put it together and you just said it; you can do math, I can do math. By itself, it might imply an expansion in the operating margin, but I don't want you to take this to the bank because investments will continue to be made in a number of areas in order to continue to have the top line grow for many, many years to come. So, we have that flexibility to be able to do that.

A - Ajaypal S. Banga {BIO 4676567 <GO>}

Just in terms of management philosophy, this is really important. We do not measure ourselves by expansion of operating margin. We do not. If you were to do that, you would think that we would be in an industry of a very mature type where expansion of margin is what I should be holding up as my management objective. So I feel we're in a growth industry with enormous opportunity as I've been saying for the last decade for the next decade.

In that industry, having the management discipline to focus on expanding the franchise, but doing it in a profitable way, is the way we present our goals. So, the idea of sticking to a minimum operating margin is just for you all, every investor, sell and buy side, to realize that we are not throwing the company out of the water, we're really working it hard and

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working every line of the P&L. But also to be honest to the way in which we operate every day and every minute of the day, which is grow the franchise and do it profitably as compared to find ways to expand the operating margin as the only management objective.

That's what we're trying to give you as a threading of the needle here. Given to myself, I would even have dropped the idea of talking about the 50% operating margin because we are beyond it already. I'm just doing it to reassure you that we are sensible and disciplined about managing profitability.

Q - Eric Wasserstrom {BIO 3626772 <GO>}

Got it, okay. That's very clear. Thank you. And then, Ajay, if I could just follow up on one strategic initiative, the expansion of the B2B Hub into Australia, is that targeting a similar sort of middle-market corporate profile? And can you give us a sense of how you're defining the TAM opportunity?

A - Ajaypal S. Banga {BIO 4676567 <GO>}

Yes, it's targeting small and middle market, not just middle market. In fact, MYOB is one of the most interesting providers of local on-the-ground expertise in providing payments and supply enablement and reconciliation services to both small and middle market corporate clients in Australia. And this partnership with them that has been a year in the making is actually very interesting for us, because it is validation of the idea of the B2B Hub that originated in the United States as being possible in another market.

And I want to take it to more markets as the next few years go by. That's the objective. But, right now, in Australia, we're just focused on executing it well to get to the 60,000 customers that MYOB has, which as I said have got a fairly large volume of revenue and payment size going through them. That gives you bill presentment, supply enablement, payments capability, reconciliation of payments versus what's due in the bill; it gives you all that capability through this relationship with MYOB (48:26).

Q - Eric Wasserstrom {BIO 3626772 <GO>}

Thanks very much.

Operator

And your next question comes from the line of Darrin Peller with Wolfe Research. Please go ahead.

Q - Darrin Peller {BIO 16385359 <GO>}

Hey, thanks, guys. Quick question on e-com growth, when you think about - I'm sorry - on overall cross-border growth. In terms of the deceleration, can you just quickly touch on the components? Was e-com holding up? Was the physical point-of-sale and then what kind of contribution from Maestro?

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And, Ajay, just a higher level question; when you think about the backdrop of an uncertain macro, can we revisit your willingness and ability to manage expenses if it were necessary? How much are you able to? Could we see a low-single digit expense growth if the economy really turned? I'd just be curious your thoughts. Thanks, guys.

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

Okay. First of all, on cross-border; so let me give you a little bit more detail. 2018, as we said, was 19% for the whole year. The fourth quarter of 2018 was 17%. And in part was obviously because of the cryptocurrency that we had in the year-ago quarter. And then there are a few ups and downs, quite frankly just to give you a little bit more detail on this one.

So, for instance, when you look at Brazil, when you look at Argentina, of course, with the devaluation of the currency, there was a bit of an impact on it. In Sweden, we had a deal lapping. In Canada, because of the stronger U.S. dollar, you have that a little bit going down. But that all was offset pretty much by a terrific performance in China and in Japan, and that's why you're not seeing a lot of variations in the Q4 numbers.

And then, when you go to January 28 days - the 28-day number, down to the 12%. Pretty much all of these factors were the same factors other than the ones that are called out, which were on top of it, right? Year-ago quarter had particularly large European cross-border in it and part of it was because of how the French take vacation by the way. And then, this year, we were hit by the snowstorm that started at the end of the first week of January.

A - Ajaypal S. Banga {BIO 4676567 <GO>}

I just want you to know she's married to a Frenchman, just to be clear. I don't want to start a political circumstance, but she is married to a Frenchman.

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

So that is a little bit - it was a hit on that one. And we called out the cryptocurrency on that one already. So, there is really nothing this year yet going on and that's why we have the confidence for the rest of the year. On e-com, you asked a particular question on that. Cross-border e-com, we saw the growth rate just growing down a tad.

Q - Darrin Peller {BIO 16385359 <GO>}

Okay.

A - Ajaypal S. Banga {BIO 4676567 <GO>}

To your question on expenses, I'm not going to tell you what number we could come to because I don't know until we're dealing with it, again, just as it was back in the 2009 and 2010 period. You should know that, if we see a sustained economic downturn then is when we'd like to take a look at some of the expenses.

My desire to play with expenses only works in a sustained downturn. If it's a quarter here or a quarter there, I'd be loathed to stop investing in the right things, whether it's new product development or its service capability or it's even the investment in the bank. But we've got a number of levers in our expenses, some of which have a shorter-term turnaround, some of which have a longer-term impact.

And you should - if you go back and look at our behavior around expenses some years ago, we're very committed to being managing our way through it. As you can imagine, when we make budgets for the year, we go through upside and downside scenarios. And given all the chatter in the environment around 2019, we've been even more careful this year in our downside scenario and our thinking around it.

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

And as you guys heard me say many times, we don't leave this up just to scenarios. We actually operationalize these scenarios. So, if we ever see that something is happening in particular in the economic environment and we need to course correct from an expense point of view, all of our business units already know today what they will have to do and it will take them very little time to revisit the plan and to execute the way that we should be executing for you guys.

Q - Darrin Peller {BIO 16385359 <GO>}

All right, makes sense. Thanks, guys.

Operator

And your next question comes from the line of Jim Schneider with Goldman Sachs.

Q - James Schneider {BIO 15753052 <GO>}

Thanks for taking my question. Good morning. I was wondering if you could maybe make - it was one question and one clarification. First of all, you talked about the various drivers of the longer-term outlook, but can you maybe quantify for us or dimensionalize the size of the B2B opportunities, especially for accounts payable and receivable? And how big that could potentially be towards the end of your forecast outlook period? And then maybe as a clarification, talk about exactly how much of a PCE slowdown you're expecting in 2019 relative to the broader longer outlook period? Thank you.

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

Jim, that really sounds like we should be helping you with your modeling question. So, listen, I'm not going to give you a lot more on B2B. You're going to have to reflect back to what we talked about the overall B2B opportunity, which is \$120 trillion opportunity, and what we said is that we are going after very particular slices of that B2B opportunity. So, we're not going to run after all of the \$120 trillion.

And some of the things that we're already investing in like the B2B Hub, like Track, like what you're hearing from us from a cross-border point of view, actually attacking those

kinds of opportunities and, of course, over the next three to five to seven years, we are going to expect that some of that will manifest itself in revenue growth.

For you 2019 question, really what we did is we put in a moderate downturn. So, it's something that we can digest within the thoughts that I gave you from a low-teens revenue number for 2019.

A - Warren Kneeshaw {BIO 16549173 <GO>}

Next question, please.

Operator

Your next question comes from the line of Harshita Rawat with Bernstein. Please go ahead.

Q - Harshita Rawat {BIO 18652811 <GO>}

Hi, good morning. Thank you for taking my question. I want to ask about emerging markets. Now, emerging markets such as India are likely a decent portion of your consumer-to-business addressable market. And on one hand, these markets are greenfield with a lot of growth opportunities. On the other hand, the competitive landscape is very different and you also have some accelerating government intervention, expansion by Chinese giants. So, in that context, can you talk about some of the steps you're taking to grow these markets and mitigate the risk of share losses and the risk of being disadvantaged by government nationalism?

A - Ajaypal S. Banga {BIO 4676567 <GO>}

The emerging markets are certainly attractive for the next decade or two. I would tell you that of the total revenue that they comprise today of our business, you would be surprised at how small they are in the totality. So, I think you've got to just think through. As I said, even in my remarks on China, we really don't play in the domestic market as of now, and so the impact on us directly is relatively small.

India is an interesting market as well. It's grown well. But, at the end of the day, the total impact to our revenue is still relatively small. That does not mean the decade from now, these won't be more attractive markets. They're growing and they're attractive. Their dynamics are different as you said. We are trying to play on multiple levels.

The first is we believe that our attitude towards of the emerging markets, be it Asia or Africa or Latin America or the Middle East, is that we are there because the governments want us there. And so we go there with respect for that government and its sovereignty and we try and work with them in a way that shows that we bring value to their economy to convert from cash to electronic payments, to get safer transactions with better data being used for safety and services of that type, as well as to get simple, seamless experiences, expand acceptance, improve the tax net (57:01), do things that governments find to be useful. And also, distribute services to the bottom of the pyramid through financial inclusion.

That's why you find us working so hard on expanding inclusive growth around the world. That's why we made that commitment of 500 million people to be reached by 2020. We're now at 360-plus-million and counting, we just got 20 million more in Mexico that I talked about. So, you can see us approaching it, first, from a societal and government level with respect for what they need for their citizenry. We do request as far as possible that we get a level playing field to be able to compete and bring the best of quality and the best of capability, so the local consumer can win.

If after that the government chooses to bias a system in some way towards a local player versus another player, that's their decision. They're entitled to make a decision in their market, playing by the rules or whatever they signed up for global engagement. That's up to that country. If their rules require them to open their market, they should. If their rules allow them to operate in a closed market, they should. It's their decision. That's the first part.

Then the rest of it is the playbook we apply everywhere else; best quality product, no differentiation in what's offered there versus a developed market, best quality of pricing, best capability of people being attached to it, global technology, global data, global cyber security standards, one technology release around the world. So, if we learn something in one country, it's available to every emerging market. Try doing that market-by-market, it's very expensive. That's what we are trying to do, just tackling it piece-by-piece; working on acceptance right from there upwards.

Look at India. Acceptance in India has grown to more than 5 million points from 1 million a couple of years ago not just because of our efforts, but also because the government's efforts to make it happen or in QR acceptance in India. So, India still has a huge opportunity. There's 60 million merchants, we've reached 5 million. There's 55 million more to go. So, my concern is less, and I'm going to shut up after this on this topic, about share from within a small pie is electronic payments. My interest is more in growing the pie of electronic payments in the emerging markets. I think that opportunity is much more liberating and much more thoughtful than trying to argue about your share in a small pie.

Q - Harshita Rawat {BIO 18652811 <GO>}

Perfect. Thank you very much.

A - Warren Kneeshaw {BIO 16549173 <GO>}

We've come to the end of our allotted time. So, Ajay, any final comments?

A - Ajaypal S. Banga {BIO 4676567 <GO>}

Sure. Thank you all for your questions. A few closing thoughts. We had a very strong end to the year, bringing 2018 to a record close. We are executing against our strategy. We're growing our core products, we're diversifying our customer base and we're building new capabilities in so many sectors and services. We continue to drive solid deal momentum.

And I think Martina and I are very pleased to outline the company's new performance objective. We feel we've positioned ourselves well with our investments and our

execution to drive continued strong growth in the future.

So, with that, thank you for continuing support of all of us in the company, and thank you for joining us today.

Operator

And with that, that concludes today's conference call. You may now disconnect.

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