Q4 2017 Earnings Call

Company Participants

- Alfred F. Kelly, Chief Executive Officer & Director
- Jack Carsky, Global Head, Investor Relations
- Vasant M. Prabhu, Executive Vice President & Chief Financial Officer

Other Participants

- Bryan C. Keane, Analyst
- Dan Perlin, Analyst
- Darrin Peller, Analyst
- Donald Fandetti, Analyst
- James E. Faucette, Analyst
- James Schneider, Analyst
- Jason Kupferberg, Analyst
- Lisa Ellis, Analyst
- Sanjay Sakhrani, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to Visa's fiscal fourth quarter 2017 earnings conference call. All participants are in a listen-only mode until the question-and-answer session. Today's conference is being recorded. If you have any objections, you may disconnect at this time.

May I now turn the conference over to your host, Mr. Jack Carsky, Head of Investor Relations? Mr. Carsky, you may now begin.

Jack Carsky {BIO 15950639 <GO>}

Thanks, Kevin. Good morning, everyone, and welcome to Visa Inc.'s fiscal fourth quarter 2017 and full-year earnings conference call. Joining us today are Al Kelly, Visa's Chief Executive Officer, Vasant Prabhu, Visa's Chief Financial Officer, and Joon Huh of our IR team.

This call is currently being webcast over the Internet and is accessible on the Investor Relations section of our website at www.investor.visa.com. A replay of the webcast will be archived on our site for 90 days. A PowerPoint deck containing the financial and statistical highlights of today's call have been posted to our IR website.

Let me also remind you that this presentation may include forward-looking statements. These statements are not guarantees of future performance, and our actual results could materially differ as the result of a variety of factors. Additional information concerning those factors is available on our most recent reports on Forms 10-K and 10-Q, which you can find on the SEC's website and the Investor Relations section of Visa's website. For historical non-GAAP or other pro forma related financial information disclosed in this call, the related GAAP measures and other information required by Reg G of the SEC are available in the financial and statistical summary accompanying today's press release.

And with that and for the final time for me, I will now turn the call over to Al.

Alfred F. Kelly {BIO 2121459 <GO>}

Jack, thank you very much, and good morning to everybody. We're actually conducting this call from our New York City office, which gives us an opportunity to do a morning call, but I do appreciate everybody joining us early in the day and obviously very early in the day if you're on the West Coast.

I'm pleased to say that we had another very solid quarter of business performance, resulting in a strong finish to our fiscal 2017. We saw our broad-based business momentum carry into the fourth quarter as we'd outperformed our expectations.

Similar to prior quarters, we saw a healthy cross-border growth globally despite lapping what was a strong double-digit quarter last year. We saw a good domestic growth in multiple countries, including India, Russia and Australia. In the United States, our domestic business proved to be resilient despite concerns about slowing retail sales data over the past quarter. And although payments volume slowed in the U.S. due to expected lapping of notable partnerships, we did see healthy payments volume growth across all the regions with total growth in constant dollars of 10%.

Processed transactions sustained a solid growth rate of 13% globally. And we had a high level of contract and renewal activity in the quarter, driving client incentives to 21.7% of gross revenue, the highest percentage for the year.

All of this led to a strong fourth quarter financial results as we delivered net revenue growth of 14% and adjusted EPS growth of 15%. After I'm finished with my remarks, Vasant will go into greater financial detail on some of the comparisons and provide more background on the numbers.

Now let me take a few minutes to cover business highlights as we had a particularly active quarter in terms of partnerships and announcements. We completed two significant partnerships in Russia and our CEMEA region. We signed a multi-year partnership renewal covering a full portfolio with Sberbank, the largest bank in the region. And we renewed a multi-year credit and debit partnership agreement with Alpha Bank.

In Asia, we executed a multi-year credit deal with Industrial and Commercial Bank of China. In Europe, we continue to make good progress with our clients. This quarter, we reached our goal and resolved approximately 75% of contracts moving from rebates to commercial incentives. We expect the remaining 25% of contract to shift into the first half of FY 2018.

On the digital product side, we launched our new mobile solution mVisa in Kenya and Nigeria, and we've been working hard to bring merchants and consumers onto that platform. We announced a global partnership with Marqeta, an innovative card-issuing platform designed to drive new commercial and consumer payments experiences.

In July, we extended our strategic partnership with PayPal to Europe to accelerate the adoption of secure and convenient online, in-app and in-store payments across Europe. In August, we launched a national rollout of Visa local offers with Uber. This allows riders to earn Uber credit for making purchases using their Visa credit card at a number of local participating merchants.

We also announced partnerships with Fitbit and Garmin to enable digital payments through their wearable devices as mobile connectivity increases. And our push payments product, Visa Direct, continue to perform very well as we saw accelerating volumes with over 75% year-over-year growth driven by North America and the CEMEA Regions.

This month, we announced our partnership with Billtrust to help streamline the reconciliation of B2B payments. We also made a strategic investment in Billtrust to help support its efforts to grow the important B2B segment. And most recently, we announced Visa ID Intelligence, which is a platform that allows issuers, acquirers and merchants to quickly adopt emergent authentication technologies and to create more and convenient ways, which are secure for consumers to shop, pay and bank on their devices. So as you can see, we had a lot of exciting activity this past quarter.

Now, I'd like to look back over the last year, which was my first year at Visa, and I'm gratified with our ability to execute our operating plan guided by our strategic pillars. As a result, we have delivered excellent financial results every quarter this year. In terms of the drivers of growth, I'd highlight the following.

First, Visa has a strong and experienced set of issuer clients who have worked hard internally and with us to drive payment volume growth. We have a real and committed focus on client engagement around the world. New partnerships like USAA and Costco were obviously big contributors in the first three quarters of the year. Economic growth around the world has been strong, which has driven increased e-commerce in more developed countries and a combination of new solutions and positively activist governments has helped drive growth in less developed countries.

The good economies around the world also spurred healthy levels of travel, which helped grow our important cross-border business, where we saw healthy results in each of our five Regions. New solutions like mVisa, which I mentioned, for less developed markets and digital solutions like Visa Checkout, Visa Direct and Visa Token Services in developed countries are starting to take hold, although I would say it is still early innings.

Our growth has been robust despite exchange rate headwinds for most of the year, and these headwinds appear to be abating as we go into next year. And then the addition of Europe to the Visa lineup has been a real catalyst for growth in 2017.

And speaking of Europe, over the past year, I've been asked repeatedly how the Europe integration is going. So let me take a few minutes to give you some thoughts on this question, and I'll do so by briefly addressing Europe in terms of partnerships, revenue, expenses, people, regulation and technology. The overall headline is that we are pleased with the progress and running well ahead of where we thought we would be. We worked hard to bring the best of Visa Inc. from around the world to Visa Europe. At a recent client event, I said that the acquisition brought Europe to Visa and the world to Europe.

In terms of partnerships, our clients in Europe are eager to bring our global innovations to Europe as fast as possible. We have more to do for sure, but we've had many senior leadership reach out to our key clients and established an innovation center in London over the past six to nine months. We have already brought a number of our digital solutions to Europe as well as some of our strategic partnerships. We held a large European client event in Barcelona about a month ago, and the feedback from clients relative to the integration and Visa in general was very good.

In terms of revenue, we have worked hard to commercialize the business by selectively introducing new pricing and moving from rebates to incentives. And again, more to do, but we are off to an excellent start.

In terms of expenses, we moved faster than anticipated rationalizing our expense base to take out redundancies. In terms of people, we've reshaped much of the Europe leadership team. The CEO who steered the acquisition left in early 2017. And I asked a Visa veteran, Bill Sheedy, to take a multi-month temporary assignment as the head of Europe, and Bill did a simply wonderful job driving the organization through the integration and all the associated changes. Bill created a team that looks more like our other regional teams around the world by elevating some Europe talent, importing Visa people from other geographies into Europe, and hiring some terrific new people from the outside.

And speaking of new people from the outside, about four weeks ago Charlotte Hogg took over as our regional leader for Europe. Charlotte comes with experience at the Bank of England, where she was the COO, Santander UK, Experian, Discover, Morgan Stanley, and McKinsey. Charlotte has hit the ground running, and I'm confident that she'll be an outstanding leader of Europe. And Charlotte will be able to continue to lean on Bill, who will remain in Europe for the next month or so.

In terms of regulation, we certainly recognize that there is more regulatory activity in Europe than the other regions. Our strategy has been to engage actively with regulators, with whom we desire to build high-quality relationships, and with our clients to make sure we shape win-win outcomes wherever possible.

Finally, relative to technology, we are on or slightly ahead of schedule. The migration of the technology platform is a key priority for us, and we have focused much time and attention on it. Our objective is a smooth transition for our European clients to a global technology platform that will open up a wider set of solutions and products.

So five quarters in, revenues are tracking above projections, expenses are below, with a lower effective tax rate. EPS accretion in FY 2017 was in the mid-single digits, and the momentum is good as we enter 2018. So as we begin fiscal 2018, I'm excited about the many opportunities in front of us. 2018 will mark the end of the first decade of Visa as a public company and the commencement of the second decade.

Relative to 2018, let me offer a few thoughts. The fundamentals will continue to matter a lot, so we will be focused on lifting our game, our client engagement across the world. We will also continue on a journey that I began on the day I joined Visa, which is to build a world-class organization in terms of talent and leadership. We have put a number of building blocks in place in the last 12 months to drive improvements in all areas of the talent continuum, and we have significantly dialed up the emphasis on leadership and the expectations that I have of the leaders at Visa.

When we talk about fundamentals, cyber security is critical, and we will continue to invest to make our technology environment and the payments ecosystem as safe as possible.

We are mid-process toward a goal of empowering our regional and country management teams in a greater way. We want to push more decision-making closer to the markets and our clients. We do so because while we are a global company, we know that the consumer businesses around the world are indeed local in nature and therefore different. In doing so, we will ensure that there is appropriate level of staging, oversight, and accountability. We will invest against initiatives that are consistent with the seven pillars of our strategy. We outlined many of our growth strategies at our Investor Day in June.

In FY 2018, we will continue to invest aggressively in a set of focus priorities. Our areas of focus include driving greater and faster adoption of our digital solutions, expanding Visa Direct, extending acceptance around the world, driving cross-border growth, and advancing Open VisaNet.

Relative to Europe, we have developed a strategy that is consistent with our global direction but customized to the specifics of Europe. We are bullish on Europe and think there's a good deal of upside. We see tremendous diversity across the markets with countries that have large cash-based economies, balanced by others that have moved to near-cashless economies. In fact, immediately following this call, I'm headed to London for two days of strategy and action planning meetings with the Europe leadership team.

As we look ahead to the next decade, disciplined capital allocation remains critical, with the following prioritization. First, our top priority is to invest at healthy levels to drive robust organic growth in our core businesses. Second, we will explore selective acquisitions that bolster our capabilities and enhance the value we can offer to our partner banks, acquirers, and merchants. Third, we will return excess cash to you, our shareholders, through dividends and buybacks.

In FY 2017, we returned $8.5 billion to shareholders in the form of share repurchases and dividends. In FY 2018, with a higher dividend payout recently authorized by the Visa Board of Directors and stock buybacks in excess of $7 billion, we expect to return over $9 billion to shareholders, even as we invest at healthy levels in our business.

In closing, our expectation is that 2018 is only the first year of a multiyear plan that ensures our second decade continues to deliver superior shareholder value through long-term sustainable growth, much as we did through the first decade.

With that, let me turn it over to my partner, Vasant Prabhu.

Vasant M. Prabhu {BIO 1958035 <GO>}

Thank you, Al, and good morning to all.

We had a strong finish to fiscal year 2017. On a GAAP basis, fiscal fourth quarter net revenues and EPS were both up 14%. As a reminder, this is the first quarter where we have Visa Europe included in our reported numbers in the prior year.

We closed fiscal 2017 with full-year net revenues of $18.4 billion, up 22%. Net income on a GAAP basis was $6.7 billion, and EPS was $2.80. On an adjusted basis, net income for the full year was $8.3 billion, up 21%. And EPS was $3.48, up 22%. All in all, a strong growth year, which exceeded our expectations, especially in Europe, which contributed with mid-single-digit EPS accretion.

Europe net revenues were ahead of our acquisition model projection, and operating expenses were below projection, with a lower effective tax rate post the legal entity reorganization we completed earlier this year. A few other points to note. Payment volumes on a constant-dollar basis, excluding Europe co-badge volume, continued to grow at double-digit rates globally. In the U.S., the step-down in growth rate reflects the lapping of Costco and USAA conversions in 2016. As a reminder, Costco started accepting Visa credit card in-store on June 20, 2016, and the first co-brand cards were issued.

USAA credit conversion was completed in September 2016, USAA debit conversion completed by October 2016. Strong cross-border constant dollar growth was sustained in the double digits. However, the weakening of the dollar, particularly relative to the euro and the pound, is starting to have an impact on the mix of cross-border business. Most notably, outbound commerce from the U.S. is slowing down as is inbound commerce into Europe, especially to the U.K. There is some improvement in outbound commerce from Europe, but no meaningful pickup yet in inbound commerce into the U.S.

These shifts will need to be monitored. Natural disasters have impacted our business. In Houston and Florida, it appears that business has largely returned to normal after some significant dislocations around the hurricane. However, the effects of the hurricanes on the Caribbean and the Mexico City earthquake are ongoing. Travel into and out of these locations continues to be below trend. As expected, we had a very active quarter on the contract renewal front. In Europe, we were able to achieve our goal of getting approximately 75% of the contract conversions from rebates to commercial incentives that we had set out to do resolved in fiscal year 2017.

Approximately 25% are shifting into the first half of fiscal 2018, largely driven by client timetable. We also had several significant renewals in China and Russia. As a result, client incentives as a percent of gross revenues were 21.7% in the fourth quarter, well ahead of the full year run rate of 19.9%. The approximately 25% of contract conversion that are shifting to fiscal 2018 in Europe reduced our incentives as a percent of gross revenues by 15 basis points in fiscal year 2017 and will add almost 50 basis points in fiscal year 2018. This shift, which amounts to around $0.03 of EPS, added 1 percentage point to our EPS growth in fiscal year 2017 and will reduce fiscal year 2018 EPS growth by almost 1 percentage point.

We repurchased 16.9 million shares of Visa stock in the fourth quarter or $1.7 billion at an average price of $102.54. In fiscal 2017, we repurchased a total of 76.1 million shares for $6.9 billion at an average price of $90.31. We also paid $1.6 billion in dividends, and our board has authorized an increase of 18% in our quarterly dividend to $0.195 per share. Finally, on September 11, we issued $2.5 billion of fixed rate notes with maturities ranging from 5 to 30 years with a weighted average interest rate of 2.78% and weighted average maturity of 14 years. On October 11, we redeemed $1.75 billion of our December 27 notes.

A quick review of the quarter's business drivers and our financial results. U.S. payments volumes grew 9% as credit grew 10% and debit grew 8%. As I mentioned earlier, the step-down in these growth rates was driven by the lapping of Costco and USAA conversions last year. Adjusted for the impact of conversion, underlying credit growth rates have been stable in the high single digits for the past four quarters.

Adjusted for Interlink, the U.S. debit growth trend was also stable. Reported debit growth ticked up from the prior quarter due to Interlink, where we are now lapping a routing loss last year. International payments volumes in constant dollars grew 10%, excluding Europe co-badge volumes in all periods. Growth trends remain stable and robust around the globe.

Global cross-border volumes grew 10%. It's important to note that cross-border growth hit double digits, normalized for Europe in Q4 2016 for the first time after several weak quarters. The cross-border growth rates held up in the fourth quarter despite tougher comparisons.

U.S. cross-border growth is slowing as the dollar weakens as well as some impact from lapping the Costco and USAA conversions. Cross-border growth in Mexico and the

Caribbean was impacted by the earthquake and hurricanes. On the other hand, outbound commerce picked up a bit from Europe as the euro and the pound have strengthened.

Other currency shifts of the Russian ruble, Japanese yen, the Brazilian real, Aussie and Canadian dollars are also changing the mix of our cross-border business, which will need to be closely monitored. Transactions processed over VisaNet grew 13%, in line with the prior quarter when normalized for Europe. Through October 21, U.S. payments volumes growth was 8.7%, with U.S. credit growing 9.9% and debit, 7.4%. Cross-border volume on a constant-dollar basis was up 7.4%. Processed transactions grew 12.6%.

Net revenues in Q4 grew 14%. While we have Europe in our prior reported numbers, it is important to note that rebates in Europe continued to be paid through the end of fiscal 2016. Exchange rate shifts helped reported Q4 net revenue growth by less than 50 basis points.

Operating expenses were flat to last year, which included severance cost related to the acquisition of Visa Europe and our global restructuring. Adjusted to exclude these special items, operating expenses in Q4 grew 8%, largely driven by personnel costs and expenses related to projects that were delayed into the fourth quarter, particularly in Europe.

Personnel costs were higher as hiring picked up post our restructuring in Europe and globally at the end of fiscal year 2016. We also incurred higher incentive accruals as performance exceeded our expectations. Professional fees ramped up in the second half around Europe technology integration as well as other key technology development programs.

Our Q4 tax rate was 31%. EPS was $0.90, up 14%. Exchange rate shifts helped reported Q4 EPS growth by almost 1 percentage point. For the full year of fiscal 2017, net revenues were $18.4 billion, up 22% with an approximately 1.5 percentage points negative currency impact. Full year adjusted EPS was $3.48, also up 22% with a currency headwind of over 2 percentage points.

With that, I'll move to our outlook for fiscal 2018. The many significant events of fiscal 2017 will have a meaningful impact on year-over-year growth comparisons in fiscal 2018. A few points to highlight before I get into the details.

First, unlike fiscal year 2017, fiscal year 2018 will lap a full year of Europe in our reported numbers. While the fourth quarter of fiscal 2017 included Europe in both years, the ending of rebates to Visa Europe members did not go into effect until the first quarter of fiscal 2017. So the first quarter of apples-to-apples revenue growth comparisons for Europe is Q1 FY 2018. Second, in Q1 FY 2018, we get close to an apples-to-apples growth comparison for Costco and in Q2 FY 2018 for USAA.

Third, the India demonetization impact started in November 2016. As you know, this led to a more than doubling of our India payment volume and processed transaction. We begin to lap this in the latter part of Q1 2018. Fourth, as we indicated, through the first half of fiscal 2017, there were delays in Europe converting contracts to replace rebates with appropriate commercial incentive terms. As such, our client incentives were significantly lower than we had anticipated in the first half of fiscal 2017. As I mentioned earlier, approximately 75% of these contract conversions were resolved by the end of fiscal 2017, and the remainder will be done primarily in the first half of fiscal 2018.

As a result, client incentives in the first half of 2018 will be significantly higher than fiscal year 2017, with incentive growth moderating in Q4 2018. Finally, our U.S. price increases went into effect in the first quarter of fiscal 2017, and our international price increases went into effect mostly in the second quarter of 2017. We will lap these price increases in the first half of 2018. Fiscal 2018 price increases are smaller in scope and will go into effect in the second half of the year. All these factors have been incorporated into our outlook for fiscal 2018. They will also impact the quarterly cadence of net revenue and EPS growth.

Let me now get into some of the details starting with payment volumes. Payment volumes globally have grown around 10% in constant dollars for the past two years normalized for Europe. Thanks to Costco and USAA, U.S. payment volume growth stepped up to the double-digit range in fiscal 2017 and will tick down to the high single digits in fiscal 2018 as we lap both conversions. International payment volume growth as reported will now reflect Europe in both years. We have been providing payment volume growth rates normalized for Europe in our data pack each quarter.

Excluding Europe co-badge volume, normalized constant-dollar international payment volume growth rates were almost 10% in fiscal 2017. We anticipate some moderation in these growth rates in 2018 due to the dual brand run-off in China and the demonetization impact in India. Global second half growth rates are expected to be better than the first half, helped by some smaller conversions in the U.S., the ramping of Visa Direct volume, and lapping the declines in China dual-brand volumes in fiscal 2017. Overall, for fiscal year 2018, our outlook anticipates high single-digit constant-dollar payment volume growth rates globally.

Moving on to the cross-border business, cross-border volumes, as you all know, are dependent on global economic conditions and the relative strength of key currencies, in particular the U.S. dollar, the euro, and the pound. Through the first three quarters of fiscal 2017, the strong dollar, weak euro and pound dynamic led to very strong outbound commerce from the U.S. and high inbound commerce into Europe, especially the UK.

In the fourth quarter, these trends started to change as the dollar weakened, especially versus the euro and the pound. Assuming these trends continue, we anticipate a slowdown in U.S. outbound commerce, with a step up in growth of commerce coming into the U.S. and vice-versa in Europe and the UK. We're assuming this trend is accentuated through the year if dollar weakness continues.

Overall, our outlook anticipates high cross-border growth is sustained in fiscal year 2018, with a change in mix as described. International revenue growth rates are expected to be higher in the second half, when some pricing actions go into effect.

The other variable that impacts our international revenues is currency volatility. After high volatility in the first quarter of fiscal 2017 post the Brexit surprise, currency volatility has been subdued through most of 2017. Currency volatility has been running below the long-term mean. For purposes of our outlook, we are assuming that volatility stay at these levels through fiscal year 2018.

Normalized to include Europe for the full year, we had healthy double-digit processed transaction growth in fiscal year 2017, helped by the Costco/USAA conversions in the U.S., the impact of India demonetization, and the processing win in Europe in the year. We expect a small step-down in growth rates in fiscal 2018 as we lap these items. We anticipate, however, that transaction growth will remain in the double digits, with generally steady growth through the year. Data processing revenue growth rates are also expected to be higher in the second half, helped by some pricing actions that go into effect.

On the client incentive front, we ended the year with incentives in the fourth quarter as a percent of gross revenues at 21.7%. Our outlook for fiscal 2018 is a range of 21.5% to 22.5%. Client incentives in the first half of 2017 averaged 18.8%, well below our expectations going into the year, primarily due to the delays in Europe. In the third quarter, this climbed to 20% as Europe contract activity picked up steam, finishing at 21.7% in Q4, which included several significant renewals in Russia and China.

With all the renewal activity in the second half of 2017, client incentive growth will be substantially higher in the first half of fiscal 2018, moderating significantly by the fourth quarter. This will be further compounded by two major renewals we currently anticipate will be completed in the second quarter of fiscal 2018 as well as the completion of Europe rebate-to-incentive contract conversions, which have shifted into the first half of 2018. The Europe rebate-to-incentive contract conversions that shifted from fiscal 2017 to fiscal 2018 lowered FY 2017 incentives as a percent of gross revenues by 50 basis points and correspondingly increased fiscal 2018 incentives as a percent of gross revenues by almost 50 basis points.

When you put this all together, our outlook is for high single-digit nominal net revenue growth in fiscal 2018, which includes the currency translation tailwind of between 50 basis points to 100 basis points. Net revenue growth in the first half is anticipated to be a couple of points below the full-year run rate and in the double digits in the second half. Net revenue growth is expected to be highest in the fourth quarter and lowest in the second quarter. This is a result of all the factors I just went through.

In terms of currency translation tailwind of 50 basis points to 100 basis points, the dollar is not weakening across all currencies. We're benefiting from dollar weakness most significantly versus the euro. As a reminder, since the euro is a functional currency, we do not hedge our exposure to the euro. Relative to the pound, weakness of the dollar hurts revenues, but this is largely offset by the expenses we have denominated in pounds. The dollar is also weaker versus other important currencies like the Canadian and Australian dollar. As you know, we hedge some of our exposure to these currencies, which offset losses when they weaken and vice-versa.

The dollar, however, remains strong or continues to strengthen versus the yen and a broad range of emerging market currencies like the Argentinian peso. We are unhedged on many of these emerging market currencies since they cannot be economically hedged. The net impact of all this is the 50 to 100 basis point impact we currently estimate based on spot rates and forward curves. As always, currencies will fluctuate.

On the expense front, we're investing in a set of key initiatives that Al described, by partially funding these investments, by shifting resources from lower priority areas, as well as from savings we derive from better purchasing and other efficiency programs. In aggregate, fiscal 2018 operating expense growth adjusted for special items in fiscal year 2017 is projected to be in the mid-single-digit range.

Included in our expenses is another $60 million in non-recurring cost related to the technology integration of Visa Europe. In fiscal 2018, we expect to start migrating clients to the global Visa technology platform. We have also included expenses related to getting our processing infrastructure up and running in China. Of course, it remains difficult to predict exactly what the timing will be on incurring these China expenses.

Expense growth cadence through the year will also not be uniform. Adjusted expense growth will be in the high single digits in the first half and the low single digits in the second half due to various factors. Coming out of our organization restructuring at Visa Europe and globally in the fourth quarter of fiscal 2016, personnel expenses were low in the first quarter of 2017 and ramped up through the year.

In addition, bonus accruals stepped up through the year as it became apparent that business performance was exceeding our expectations. We have the Winter Olympics in the second quarter, which will result in higher marketing expenses versus Q2 last year. The Europe integration cost is also first half loaded as we complete the technology platform harmonization and start client migration.

Finally, many of our investment initiatives ramped up through the second half of fiscal 2017, and spend rates on these initiatives will be higher in the first half of fiscal 2018 than they were in the first half of last year. The adjusted expense growth rate is expected to be highest in the first quarter and the lowest in the fourth quarter of fiscal 2018. Our adjusted tax rate in 2017 was almost 30%, helped by the part-year benefits from the legal entity reorganization we completed midyear.

Our outlook projects 100 basis points reduction in our tax rate for fiscal 2018 since we will get the full year benefit of the tax reorganization. This tax rate outlook does not include any impact from possible tax reform. Putting all these components together, our outlook is for EPS growth at the high end of mid-teens on an adjusted non-GAAP nominal dollar basis. This includes 1 to 1.5 points of positive foreign currency translation impact.

As mentioned earlier, the underspend on client incentives in Europe with some renewal shifting into FY 2018 added approximately 1 percentage point to EPS growth in fiscal 2017 and will reduce EPS growth by almost 1 percentage point in fiscal 2018. With net revenue and operating expense growth rates fluctuating from quarter-to-quarter, EPS growth rates will, too. The EPS growth rate based on all these assumptions will be lowest in the second quarter, below the low end of the mid-teens range and at the highest level for the year in the fourth quarter, well above the mid-teens range. In the first and third quarters, we anticipate mid-teens EPS growth.

We know all this quarterly fluctuation does not make it easy for you to build your model. We wanted to give you as much color as we could, and we'll, of course, update our outlook each quarter as we normally do as well as provide a point of view on the upcoming quarter. For the first quarter of fiscal 2018, our outlook is for net revenue growth a couple of points below the full year rate, high single-digit operating expense growth and mid-teens adjusted EPS growth.

Moving on to capital, cash flow, dividends and buybacks. Capital spending in fiscal 2018 is likely to be around $800 million. This includes capital associated with the Europe technology integration, capital to set up processing operations in China and spending on hardware to support growth as well as capitalization of software from our technology development projects.

Based on our earnings outlook and capital spending, free cash flow from operations is anticipated to be in excess of $9 billion. Most of this free cash flow will be returned to shareholders in the form of dividends and buybacks. The Visa board has authorized an 18% increase in our quarterly dividend to $0.195 for the first quarter of fiscal 2018. In line with our stated dividend policy, this puts our payout ratio in the 20% to 25% range.

We anticipate buying back over $7 billion of Visa stock during fiscal 2018. As you know, we've been buying stock in excess of our normal buybacks from free cash flow since the Visa Europe acquisition to neutralize the impact from stock issued to Visa Europe members. In fiscal 2018, we will complete this aspect of our buyback program.

As I mentioned earlier, we issued $2.5 billion in debt in three tranches with a weighted average maturity of 14 years. After redeeming our December 2017 two-year notes, gross debt now stands at $16.75 billion. Our gross debt-to-EBITDA ratio is in the 1.2x to 1.5x range we are targeting, but towards the lower end of the range as EBITDA has grown.

Since we stretched out maturities and added some indebtedness, interest expense will increase 10% in fiscal 2018. After we completed our legal entity reorganization, we have returned a net $5 billion in offshore cash to the U.S. At the end of September, total cash on hand including marketable securities stood at $15.3 billion.

This includes cash from the September debt issue. We used $1.5 billion of this cash in October to redeem all of our two-year notes. We're monitoring developments from the tax reform front as we develop strategies to return more cash back to the U.S.

We will adopt the new revenue recognition standard on October 1, 2018, the beginning of our fiscal 2019. If applied to fiscal 2017 reported results, the impact of the new standard would have been immaterial. The impact to future years is partially dependent on the terms of new incentive deals executed going forward and will, therefore, vary.

We will continue to assess the impact of the new standard throughout fiscal 2018 and provide you an update if we believe that the application of the new standard to new deals in aggregate could have a more significant impact on reported results. As a reminder, the new accounting standard has no impact on cash flows or the economic value of our business.

In summary, the power of the Visa business model enhanced by the acquisition of Visa Europe delivered 22% net revenue and adjusted EPS growth in fiscal year 2017. Europe contributed with mid-single-digit EPS accretion.

At the end of the first year post-acquisition, Visa Europe is well ahead of our revenue projection, below our cost projection with a lower effective tax rate. If we achieve the goals we have for Europe in fiscal year 2018, cumulative EPS accretion will be in the high single digits, and operating margins will be at or above Visa Inc. margins. We're poised to deliver another year of the robust revenue and earnings growth we have come to expect from Visa while continuing to invest in our business at healthy levels to sustain this growth into the future.

Jack Carsky {BIO 15950639 <GO>}

And with that, we're ready to take questions, Kevin.

Q&A

Operator

Thank you, speakers. Our first question comes from Sanjay Sakhrani from KBW. Your line is now open.

Q - Sanjay Sakhrani {BIO 7390132 <GO>}

Thank you, good morning. I appreciate all the color on 2018, Vasant. I was just wondering if you could talk about what your expectations are for Visa Europe's accretion in 2018. And when we think about sort of where the surprises could be, it sounded like in 2017, it was on the expenses. Should we assume like in 2018, it could be more on the pricing side? Thanks.

A - Vasant M. Prabhu {BIO 1958035 <GO>}

Yes. As I mentioned, it was sort of mid-single digits accretion in 2017 and cumulatively getting to the high single digits, so you could say once again, it adds probably in a low single digits accretion in 2018, so generally in that ballpark. So as you know, that's ahead of where we expected to be at this stage.

No, I would say as Al said to that, 2017 performance was driven as much by revenue as expenses. So the revenue picture has been strong in Europe for two reasons. The local economies, they have been strong, and cross-border was particularly strong in Europe in

2017 because of the weak pound and the euro, a lot of cross border into the U.K. especially.

And as we look at 2018, the economic situation in Europe at least as we look at it still looks very strong at a local level and the cross-border business is holding up. So it's going to be, again, I think revenue being a major driver of it. I don't know, Al, if you have something else.

A - Alfred F. Kelly {BIO 2121459 <GO>}

No, I think that's fair. I think as I said, we're bullish on Europe, and I think it's a combination of what we're getting done on the revenue side and the expense side.

A - Vasant M. Prabhu {BIO 1958035 <GO>}

And of course, we got the legal entity reorganization done, which meant that the effective tax rate on our European earnings is lower than what we might have expected immediately post the transaction.

A - Jack Carsky {BIO 15950639 <GO>}

Next question, please.

Operator

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

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

Hi, guys. Just wanted to follow up on that. The high single-digit EPS accretion by 2018, that will be two years earlier than the original plan. I think it was for high single digits by fiscal year 2020. Just thinking about going forward into 2019 and 2020, is there some upside now to the original guidance on EPS accretion in Europe now that we're ahead of plan and there is probably more to do in the out-years? Thanks.

A - Alfred F. Kelly {BIO 2121459 <GO>}

Bryan, I think we're, at this point, laser beam focused on 2018 and trying to take this in one step at a time. I think we feel very good about where we ended 2017. We feel very good about where we think we're going to head in 2018. And hopefully, there's a trend there. But right now, we're focused on 2018 and getting to that next step in terms of the value that Europe is delivering to the entire Visa enterprise.

A - Jack Carsky {BIO 15950639 <GO>}

Next question, Kevin.

Operator

Our next question comes from Dan Perlin from RBC Capital Markets. Your line is now open.

Q - Dan Perlin {BIO 1758057 <GO>}

Thanks, good morning. So I had a question on the high 60s margin guidance for 2018. I appreciate all the expense color you guys gave. Historically, that's been a mid-60s number. And the question really is the business model at a kind of pivot point, whereby you really just can't kind of outrun the incremental margin anymore with really the pace of investment or is this just kind of a one-off, where we're going to be running in the high 60s? Thanks.

A - Vasant M. Prabhu {BIO 1958035 <GO>}

I think as we've always said, we don't have margins as an objective. We focus on driving volumes. Clearly, the focus is on converting cash, driving volumes, driving revenues. As long as revenues are growing in the high single digits and with the appropriate level of investment given the nature of our cost structure, expenses are growing in the mid-single digits, you're going to get margin improvement. And margins are not an objective. It's an outcome. And Al?

A - Alfred F. Kelly {BIO 2121459 <GO>}

I think the only other dynamic I'd remind you of, Dan, is that we're seeing based on the actions we're taking fairly good margin expansion in Europe, which is now a part of the overall mix of the margin number for all of Visa. But other than that, I would agree totally with Vasant's comment, which is we're going to invest at the level that makes sense and we feel good about and margins as an outcome, not a goal.

A - Jack Carsky {BIO 15950639 <GO>}

Next question, please.

Operator

Our next question comes from Don Fandetti from Wells Fargo. Your line is now open.

Q - Donald Fandetti {BIO 6095992 <GO>}

Hi, good morning. Al, sort of a longer-term question. If you look around the world at what's going on with Alipay and real-time payments, at some point, do you get worried that there could be some leakage to the secular opportunity or do you feel like that is something that's premature in terms of worrying about?

A - Alfred F. Kelly {BIO 2121459 <GO>}

Don, I think a good characteristic of any CEO is to be a bit paranoid. And while we just talked about very, very strong results in FY 2017, I can tell you that we are really laser-focused on the future and the fact that there are disruptive forces in the marketplace.

I think that as it relates to real-time payments, I think we feel like we've got a very good tool in our toolbox in terms of Visa Direct. And as I said in my remarks, we saw volume on Visa Direct rise 75% year over year. The likes of Alipay and WeChat have done a phenomenal job in China and have started to migrate to other geographies. And you can rest assured that it is something that we pay a tremendous amount of attention to, and we're going to do everything we can to make sure that we remain a key player at the focal point of the payments ecosystem.

A - Jack Carsky {BIO 15950639 <GO>}

Next question, please.

Operator

Our next question comes from Jason Kupferberg from Bank of America Merrill Lynch. Your line is now open.

Q - Jason Kupferberg {BIO 6867809 <GO>}

Good morning. I just wanted to ask on cross-border. Can you walk us through the reconciling items in Q4 between volume growth and revenue growth? At least in our model, the big revenue upside was on cross-border. And then just any thoughts or comments around the intra-quarter cross-border volume slowdown through October 21? I know it's only a few weeks of data, but any callouts there? Thanks.

A - Vasant M. Prabhu {BIO 1958035 <GO>}

I'm not exactly sure what you're referring to as far as the volume and revenue growth aspects of the fourth quarter. There was nothing unusual in the fourth quarter. It was a pretty steady growth quarter. There should not be anything unusual there unless I'm not fully understanding your question.

As far as it relates to the first three weeks of October, we've said over and over again in the past that three weeks don't make a trend. Having said that, why is the number 7.4%? There's a little bit of shift in what are these intra-Europe cross-border volumes that accounts for probably 1.5 points or so of the difference from last quarter. Intra-Europe, sometimes acquirers and merchants can shift where they acquire the volume, and that can cause something that was considered an intra-Europe transaction to a domestic transaction. It doesn't have much of a revenue impact, but we do see that within the EU.

The other factors are really driven more by a strengthening dollar causing some slowdowns, as I said in my comments, on outbound commerce from the U.S. and some limited impact from what's happening in the Caribbean and Mexico. But again, there's a lot going on in cross-border with these currency shifts, and we'll just have to wait and see. We feel pretty good about it.

A - Alfred F. Kelly {BIO 2121459 <GO>}

The only thing I'd add is again, a small impact, but it's the lapping of some of the U.S. conversions.

A - Jack Carsky {BIO 15950639 <GO>}

Next question, Kevin.

Operator

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

Q - Lisa Ellis {BIO 18884048 <GO>}

Hi. Good morning, guys. Al, just a question about Europe. You gave pretty bullish commentary on the outlook for Europe, and in particular highlighting the disparity across countries there with card penetration or digital payment penetration. But that is the region also where there is prevalence in some countries of these bank transfer-based networks that have gotten a lot of traction. Can you walk through your view on how debit goes head to head versus these networks? What's the difference in functionality? What's the difference in the value proposition to the merchant, to the issuer, et cetera?

A - Alfred F. Kelly {BIO 2121459 <GO>}

Lisa, thank you for the question. I think I mentioned I'm heading to London right after this call, and this is actually something that's on our agenda to discuss. The issue you raise is real. I think in the case of Europe, as a reminder, the bulk of our business or a large percentage of our business is in the UK. And as we actually look to penetrate further into the continent, we're going to have to make sure that we have strong offerings in credit as well as debit. And we, by the way, tend to be even further behind in credit in some markets than we are in the case of debit. And we're going to have to make sure that our value propositions are differentiated in certain ways to make sure that we are indeed a player. But there's no question that these country-based networks are something we're going to have to contend with.

A - Jack Carsky {BIO 15950639 <GO>}

Next question, please.

Operator

Our next question comes from Darrin Peller from Barclays. Your line is now open.

Q - Darrin Peller {BIO 16385359 <GO>}

Thanks, guys. A two-part question, but first, I understand you have more tough compares in 2018, including higher incentives as a catch-up, but fourth quarter did sow some of that increase in incentives already obviously, and yet you were able to do 14% growth. So just are the other factors like pricing enough for the difference down to high single digits in guide?

And then just a longer-term part of the question is, I guess incentives are guided up again. If we took out the idea of a catch-up, again, bigger picture, should investors expect a more normalized growth in incentives after 2018 just based on pricing environment seeming to be somewhat stable in the overall market? So just bigger picture comments on incentives growth after the catch-up.

A - Alfred F. Kelly {BIO 2121459 <GO>}

In the case of the first question, the guidance we're giving is our best assessment of where we see the business going at this point in time for 2018 with all of the various information that we have at our hands. In terms of the client incentives question, Vasant?

A - Vasant M. Prabhu {BIO 1958035 <GO>}

On the first part of your question, which is your revenue growth was 14% despite incentives being 21.7%, I just want to make sure you heard what I said about the fact that in the fourth quarter of 2017, while we were lapping Europe in 2016, the rebates were still in place in the fourth quarter of 2016. So it's not apples-to-apples yet for Europe on the revenue front because the rebates stop being paid in the first quarter of fiscal 2017. So you really only have to get out of the first quarter of 2017 where you're comparing Europe one year to the other in a real apples-to-apples way. That's number one.

Number two, we went through some of the Costco/USAA comparatives. So there are a couple of factors that make the fourth quarter that we just had have things in it that are not going to be like what you've seen in the first quarter and beyond next year.

As it relates to incentives, yes, some of it is the shift. But as you know, we just went through in Europe a large number of what we call contract conversions from rebates to incentives. All those now flow through the incentive line next year, so clearly that's a factor. And then we had, as you heard, several large renewals this year. That flows through. And we don't really want to comment on what happens in 2019 and beyond. But as Al said, we've given you the best picture we can of what to expect in 2018.

A - Jack Carsky {BIO 15950639 <GO>}

Next question, please.

Operator

Our next question comes from Jim Schneider from Goldman Sachs. Your line is now open.

Q - James Schneider {BIO 15753052 <GO>}

Good morning. Thanks for taking my question. I was wondering if you could maybe touch on the data processing line. That line has consistently done better than we expected. And I think on the last call, Vasant, you referred to the fact that you had picked up some specific wins. Can you maybe just kind of frame that line and the expectations for 2018 and beyond in terms of where you might be thinking of market share, in what regions and if Europe is specifically a possibility for further share gains there?

A - Vasant M. Prabhu {BIO 1958035 <GO>}

Yeah. I wouldn't emphasize share gains per se. Yes, we had a gain in Europe, which did help the growth rate in that line. But data processing has been a very healthy business. It's a great business. As I think Al mentioned, we would like to increase processing around the world. It has been growing in that 13% range all year while clearly having Costco and USAA come in the U.S. helped that, too. As we look ahead, we said we'd see a little bit of a step-down because of these lapping effects but still healthy double-digit growth. Beyond that, there really wasn't anything remarkable there. It's just a good, strong, fast growth business.

A - Jack Carsky {BIO 15950639 <GO>}

Next question please.

Operator

Thank you. Our next question comes from James Faucette. Your line is now open. One moment please.

Q - James E. Faucette {BIO 3580933 <GO>}

...with regulators in Europe has been...

A - Alfred F. Kelly {BIO 2121459 <GO>}

I'm sorry. You just came in with the first part of the question. Can you start again?

Q - James E. Faucette {BIO 3580933 <GO>}

Sure. Hey. This is James Faucette, Morgan Stanley. Al, it's a question for you. You mentioned in your prepared comments that your engagement with regulators perhaps is most active in Europe, and I'm wondering if you can just give a little bit of color as to what you view as the objectives of the regulators in Europe and the pieces that Visa can have that can help address the things that regulators are looking at. And I guess, as part of that, just give an update as to what you're seeing with your partners as – with PSD2, et cetera. Thanks.

A - Alfred F. Kelly {BIO 2121459 <GO>}

So I think there's a number of objectives that the regulators have. They're looking for – to protect the privacy of consumers. They're looking to make sure that transactions are as secure as they possibly can be. They're looking to create and foster more innovation and allowing FinTechs to get into the stream a bit more, and that's facilitating the idea of opening up access to bank accounts around Europe as defined in PSD2. So I think that what the regulators are trying to accomplish is relatively clear.

I think where it all lands and what the various use cases that might develop is probably less clear. We focus on a couple of things. One is making sure that we are having good open dialog with the regulators so that they understand our point of views and have clarity around what exists that's good in the payments ecosystem and how the payments ecosystem is evolving.

Secondly, we're working closely with our clients, particularly issuers and acquirers, around Europe to understand what are some of the implications and frankly, what are potentially some of the opportunities, making sure that we help them as they try to meet the authentication hurdles that the regulators want people to achieve as well as understanding the implications of PSD2 and open access to accounts and what that might mean. And I think we have found ourselves having excellent dialog with clients throughout Europe, and it's something that we'll be continuing to focus on. I actually will meet with regulators tomorrow when I'm in London.

A - Jack Carsky {BIO 15950639 <GO>}

And with that, we'd like to thank you all for joining us today. If anybody has follow-up questions, please feel free to call myself or Joon. Thanks, again. Have a great day.

Operator

And that concludes today's conference. Thank you all for your participation. You may disconnect at this time.
