Q3 2018 Earnings Call

Company Participants

- Alfred F. Kelly, Jr., Chief Executive Officer & Director
- Mike Milotich, Senior Vice President-Investor Relations
- Vasant M. Prabhu, Executive Vice President & Chief Financial Officer

Other Participants

- Bryan C. Keane, Analyst
- Daniel R. Perlin, Analyst
- Darrin Peller, Analyst
- David J. Koning, Analyst
- Harshita Rawat, Analyst
- James E. Faucette, Analyst
- James Schneider, Analyst
- Lisa Dejong Ellis, Analyst
- Sanjay Sakhrani, Analyst
- Tien-Tsin Huang, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to the Visa's Fiscal Third Quarter 2018 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.

I would now like to turn the conference over to your host, Mr. Mike Milotich, Senior Vice President of Investor Relations. Mr. Milotich, you may now begin.

Mike Milotich {BIO 20581476 <GO>}

Thank you, Katie. Good afternoon, everyone, and welcome to Visa's fiscal third quarter 2018 earnings call. Joining us today are Al Kelly, Visa's Chief Executive Officer; and Vasant Prabhu, Visa's Chief Financial Officer. This call is being webcast on the Investor Relations section of our website at www.investor.visa.com. A replay will be archived on our site for 30 days. A slide deck containing financial and statistical highlights has been posted to our IR website.

Let me also remind you that this presentation includes forward-looking statements. These statements are not guarantees of future performance and our actual results could differ materially as a result of many factors. Additional information concerning those factors is available in 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 our website. For historical non-GAAP financial information disclosed in this call, the related GAAP measures and reconciliation are available in today's earnings release.

And with that, let me turn the call over to Al.

Alfred F. Kelly, Jr. {BIO 2121459 <GO>}

Mike, thank you and good afternoon to everybody and thanks for joining us today. We are very pleased with our third quarter results. Revenue growth was 15% as all of our key economic drivers remained strong. The healthy global economic fundamentals we've seen in the past few quarters have largely continued.

Payments volume growth on a constant dollar basis of 11% accelerated modestly versus the prior quarter fueled by faster growth in almost every region and higher credit growth. Cross-border growth on a constant dollar basis of 10% decelerated by 1 percentage point versus the prior quarter largely due to the stronger dollar.

Processed transaction growth was consistent with the last quarter at 12%. Expense growth adjusted for the U.S. litigation provision increase was 14% as we continue to invest in talent and deploying new capabilities in markets around the world. Adjusted EPS growth was 39%.

We also returned approximately $2.2 billion of capital to shareholders this quarter consisting of almost $1.8 billion of share repurchases and nearly $500 million through dividends. Vasant will take you through our results and our full-year outlook in more detail when I complete my remarks.

Regarding the U.S. interchange multidistrict litigation or the MDL provision increase of $600 million this quarter, we continue to make progress in resolving this litigation and have reached an agreement in principle with the class seeking monetary damages. That agreement is subject to negotiation of a full written agreement and those negotiations are ongoing.

Discussions with the class seeking injunctive relief are also ongoing. We will make an announcement related to any agreement if and when any settlement agreement is finalized.

Now let me share updates from around the world starting with Europe. We continue to be very pleased with our performance in Europe and feel there is substantial runway for growth moving forward as the integration nears completion. We see significant opportunity over time across three broad tracks: the acceleration of payments volume growth, country-specific opportunities and increasing yield.

First, we can accelerate our volume growth by displacing cash in key markets and increasing our share of domestic transactions. Cash still accounts for a sizable share of consumer spend in several of Europe's largest economies, such as approximately 60% in Spain, Italy, and Poland. Nine markets in Europe have an active or a large domestic card scheme, where we feel we have competitive advantages based on our innovative investments and digital capabilities.

We're also enabling Fast Funds for Visa Direct driving contactless payments and working more closely with FinTechs on new and innovative offerings. This quarter we announced the FinTech fast-track access program to accelerate speed-to-market by onboarding FinTechs with Visa in four weeks.

We also launched $100 million European investment program to support the FinTech ecosystem, building upon investments we've already made in companies like Klarna and solarisBank. Second, there are opportunities to gain share on specific markets within Europe as our current business is relatively concentrated. We plan to target faster growing markets and markets where we have lower share with investments in talent to support clients' innovative product solutions and enhanced marketing.

Finally, there's opportunity to increase yields in Europe. First, we are focusing more on higher yielding consumer and commercial credit volumes. Prior to our acquisition, Visa Europe as an association was very debit-centric and did not focus much on credit; second, driving client adoption of value-added solutions, leveraging our global VisaNet platform capabilities, particularly our risk products, processing and services relevant in a PSD2 environment.

Thirdly, we continue to see pricing opportunities in Europe. As we get closer to the end of the Europe technical integration work and the transition of our existing clients to incentive contracts, we are shifting our focus to these growth opportunities. I will talk more about the technical migration in a moment, but I'd be remiss not to mention the partial disruption of our European processing experience on June 1.

We, at Visa, hold ourselves to very high standards, so any impact on our processing for any period of time is unacceptable and we take it very seriously. That said, let me clarify a few points. It was not an outage, and in fact, approximately 95% of unique transactions attempted over the 10-hour period were completed successfully.

The partial service disruption was on Visa Europe's legacy processing platform and it was completely unrelated to the migration. Our global VisaNet platform was not affected. If you'd like more details, I direct you to our letter to the UK Parliament's Treasury Select Committee, which is posted on their website.

Now let me say a few words about the technology migration. We are very happy with the progress made to date. As you know we completed the clearing and settlement migration in March and the authorizations migration began in April. We now have over 50% of our processing volume migrated for authorizations, which includes a number of our largest

European clients. We remain on track to complete the technical migration by the end of the calendar year.

To wrap up on Europe, the financial performance of the deal continues to exceed expectations. Vasant will get into more detail, but double-digit accretion we now expect in fiscal year 2018 is two years ahead of our original acquisition expectations.

Moving on from Europe, let me shift to other markets around the world, starting in Asia. In India, we continue to be the market leader with payments volume growth well over 20% this quarter. We recently announced revised debit pricing to address regulator-driven changes in debit economics as the market evolves, particularly on transactions under INR 2,000, an equivalent of roughly $30.

We expect incremental volume to largely offset this price reduction over time. We are also engaged with the Indian regulator to find possible solutions to best address their data localization concerns. So far this is a very productive dialogue, and we will keep you updated as our requirements are finalized.

In Thailand, our local debit network is now live. We are now one of three debit networks operating in the country, the other two being regional operators. Visa is the only network to offer a unified single brand acceptance both in Thailand and globally bringing a consistent end user experience to the consumers there.

The launch of our domestic network enables Visa to fully participate in the domestic payment market and continually drive digital payment innovations for consumers and businesses, while also fostering a financially inclusive ecosystem in Thailand.

In Australia, we've seen impressive payment volume growth of about 20% in the last few quarters relative to the market average growth of 7%. This is a direct result of successful portfolio migrations tied to significant long-term exclusive contracts struck with existing clients as well as our continued growth momentum in both debit and contactless. Over 93% of all face-to-face transactions are now contactless in Australia.

In Taiwan, more than 2 million Visa co-branded credit cards with Costco Taiwan and Cathay United Bank have been issued to date, which makes it the largest co-brand in the market.

Let me also share a few quick highlights in other regions. CEMEA is at the center of our Visa on mobile, formerly known as mVisa efforts (00:10:00). We are live and gaining traction in a number of markets, including launches in Ukraine and Kazakhstan and in Kenya, Pesapal, a leading payments facilitator in East Africa providing merchants online and face-to-face payment processing, integrated Visa on mobile into its payments processing platform. And it will be making it available more than 21,000 businesses for online and in-store payments.

To help support these small merchants grow their businesses, Visa is also rolling out a digital microlending partnership with Branch to provide preferential loan terms to qualified Visa merchants who accept Visa on mobile QR codes. Branch is a machine learning powered provider of mobile financial services to emerging markets and has the second most downloaded app in Kenya.

In Latin America, we made a strategic investment in YellowPepper, a mobile payments pioneer in the region, to help accelerate innovation in digital payment technology. The initial focus will be growing tokenized payment opportunities, increasing access to our APIs, expanding the usage of push payments via Visa Direct. Together, we're already working with more than 70 clients in the region.

In terms of advancements with Visa Direct, Visa Direct continues to grow rapidly fueled by geographic expansion, the enablement of new use cases and repeat customer usage. Volume has more than doubled in the past year and is beginning to have an impact on our overall debit volume growth, particularly in the United States.

The Visa Direct platform can deliver transactions to our 2 billion Visa debit cards globally, has cross-border capabilities and has already sent transactions to more than 150 countries this fiscal year.

More than 1 billion of those debit cards across almost 70 countries are enabled for Fast Funds. We are continuing to work with issuers around the world to upgrade the transaction speed to Fast Funds. Unlike many other real-time payment options, merchants and acquirers that already use our platform can now utilize global Fast Funds without any additional step once they are enabled as an issuer.

There are three partnerships related to Visa Direct that I want to highlight. One, we're partnering with MoneyGram, the second largest money transfer provider in the world, to deliver domestic and cross-border remittances utilizing debit credentials to receive funds. Cross-border remittances is a large attractive market that currently has a lot of friction for people receiving funds.

Second, we're partnering with Postmates, a logistics company that operates a network of couriers who deliver goods locally, to enable instant payouts to the delivery couriers in their fleet.

Third, OnDeck launched a new Instant Funding feature for lines of credit for small businesses. Once a business registers their Visa Debit card, they can make a drawdown and receive their money transfer in seconds any time, day or night.

Given that cash flow management is a critical issue for small businesses, the flexibility to receive funds when the bank is closed is very valuable. Not only is Visa Direct effective at capturing new payment flows, but it also stimulates our core business by increased spend per card. Based on a recent study of debit card users in the U.S., after receiving their first Visa Direct payment, they exhibit a continued level of incremental spend. And that transaction list was consistent for debit users with all levels of engagement, ranging from previously infrequent debit users to very active debit users.

Let me shift to B2B. We're investing in existing solutions while also expanding into new payment flows. B2B payments through existing solutions represents over 11% of Visa's payment volume and are growing at a faster rate than Visa overall. With the approximately $20 trillion market sizing for existing solutions, we see significant growth opportunity for virtual cards and Visa Direct in particular.

The virtual cards are increasingly important way which businesses transact with each other. We are now partnering with WEX, a leading commercial card issuer, serving the travel, insurance and media industries among others. This arrangement allows WEX and their corporate payment customers to use a Visa virtual card to enable global B2B payment.

Additionally, the Fraedom integration is going well and response from our issuers has been very positive. We're in advanced discussions to utilize Fraedom more broadly with issuers in North America, Europe, and Asia.

Lastly, we continue to expand our B2B offerings to new payment flows. While this is a very large market opportunity well beyond the size of what is currently addressable with existing solutions, it is complex and heterogeneous, and therefore will take time to fully capture the benefits.

We are starting by focusing on high-value cross-border transactions, which we view to be one of the largest single pain points in B2B payments today. We're addressing this with our B2B Connect solution. We are now in pilot and are on track to expand the availability of B2B Connect in the first half of calendar year 2019.

We continue to make great progress in contactless, a quick update. Global contactless penetration of domestic face-to-face transactions that run over our network was up approximately 2 percentage points since last quarter with 18 countries increasing at least 5 percentage points in the last three months.

There are now 10 countries where over two-thirds of their domestic face-to-face transactions are contactless and over 30 countries that are at least one-third contactless. And those 30-plus countries, which excludes the United States, represent 70% of the non-U.S. Visa domestic face-to-face transactions in Q3.

Transit continues to be a strong driver of contactless adoption around the globe. Announcements in the past quarter include both TransLink in Vancouver and Azienda Trasporti in Milan having enabled contactless payments at the transit gate.

MetrôRio, Rio's largest transit operator with 240 million annual riders, announced that they will begin accepting contactless payments at the transit gate with the initial launch scheduled for later this summer.

Mumbai announced that its Integrated Ticketing System, which is used by 14 different transit agencies in and around the city that collectively carry 11 million people every day, will begin accepting contactless payments soon.

And finally in the U.S., the New Jersey Transit agency announced that they would be joining New York's MTA and Boston's MBTA in enabling contactless payments at the gate.

A quick update on Visa Digital Commerce Program often now referred to as the common button. Feedback continues to be very positive as we talked with more ecosystem participants, including merchants, acquirers, gateways, issuers, and digital platforms.

EMVCo continues to make progress on three major work streams. First is the definition of the Secure Remote Commerce Mark, which will be used in merchant shopping and customer-facing applications to indicate to consumers which merchants and cards are enabled for Secure Remote Commerce; second, user experience standards that define the checkout flow; and thirdly, technical specifications for ecosystem participants so that everyone can begin coding. We expect the detailed technical specifications to be published by the fall of this year, followed by the user experience and branding specs later this year, maybe into early next year.

We continue to work as quickly as possible with EMVCo to get the standards right. We don't expect the migrations of Visa Checkout will happen before the middle of next calendar year.

The FIFA World Cup in Russia was an overwhelming success for Visa over the past two months. The client and consumer experiences provide a unique opportunity to showcase Visa's innovative – innovation and connect both clients and consumers to the evolving portfolio of Visa's offerings. Over 500 bank and merchant partners across 103 markets in 24 languages utilized the Visa sponsorship to support their local strategies. The Visa brand was very visible, canvassing the field board for over seven hours on broadcast during the 64 matches of the World Cup, which is estimated to have exceeded three billion unique viewers.

Excluding those field boards, Visa had well over 5 billion digital impressions over the course of the tournament in 48 countries. The World Cup is on track to be the most viewed sporting event ever on digital platforms, setting streaming records in major markets including China, France, the United Kingdom, and the United States.

Finally, a few closing comments. We're now almost one-third of the way through our fiscal fourth quarter, and it's shaping up to be another strong year for Visa. We're currently in the midst of many strategic discussions that will inform where we invest over the next couple years, which obviously will flow into our fiscal 2019 budgeting and investment programs. We're focused on sustaining our strong business momentum as we close out fiscal year 2019 (sic) [2018] and on October 1 launch into 2019.

With that, let me turn it over to Vasant.

Vasant M. Prabhu {BIO 1958035 <GO>}

Thank you, Al. We're very pleased to report another strong quarter, with net revenue growth increasing to 15%, driven by continued momentum across all three of our business drivers. As reported on a GAAP basis, EPS grew 16%. This includes a special item, which I will describe in more detail in a moment.

Adjusted to exclude this special item, EPS grew 39%, which includes a 10 percentage point benefit from the impact of U.S. tax reform. Exchange rate shifts versus the prior year positively impacted net revenue growth by approximately 1.5 percentage points and EPS growth by approximately 3 percentage points.

A few points to note. As we recently disclosed, based on progress in settlement discussions in the U.S. Interchange Multidistrict Litigation, we recorded a $600 million litigation provision and related tax benefit of $137 million in the third quarter. This special item is included in our reported GAAP results, with operating expense growth of 53% and EPS growth of 16%. Excluding this special item, adjusted operating expense growth is 14%, and adjusted EPS growth is 39%.

Related to this, on June 28, we deposited an additional $600 million into the litigation escrow under the terms of the U.S. retrospective responsibility plan. Funding of the escrow triggers a conversion rate adjustment of class B common stock to shares of class A common stock, which has the same effect on EPS as repurchasing $600 million of class A common stock.

Growth across business drivers continued at double-digits. Payments volume and processed transactions growth remained strong and steady at 11% and 12% respectively, with cross-border volume growth decelerating to 10%, primarily due to a stronger dollar.

Client incentives are lower than expected due to some contract signing delays, as well as lower than forecast incentive levels. Contract signing delays added $0.01 to $0.02 to Q3 results. We expect higher client incentives in the fourth quarter due to these signing delays. Our tax rate benefited this quarter from the successful resolution of a tax audit. This is a non-recurring benefit of 2.9 percentage points in our GAAP tax rate, and 2.4 percentage points in our adjusted tax rate this quarter.

We bought back 13.6 million shares of class A common stock, at an average price of $128.80 for $1.8 billion this quarter. Year-to-date buybacks totaled 46 million shares, at an average price of $119.60 or $5.5 billion. This leaves $5.8 billion available for share repurchases as of June 30.

Including the impact of the conversion rate adjustment of class B shares to shares of class A common stock related to the $600 million deposit into the litigation escrow account, our effective year-to-date buyback totaled $6.1 billion.

Moving now to a review of key business drivers in the third quarter. Payments volume on a constant dollar basis grew 11% again this quarter. U.S. payments volume growth accelerated from 10% to 11% due to strong debit spending and commercial volume growth.

U.S. consumer debit growth accelerated, fueled by positive macroeconomic conditions, Visa Direct, and rising gas prices. Commercial volume has been accelerating steadily in the past three quarters, with gains across small business credit, large and middle market programs.

International payments volume also grew 11% on a constant dollar basis. Growth stepped up across Asia, driven by China, India, and Korea, and in Latin America, driven by Brazil. Growth across the Middle East and North Africa accelerated. Growth in Europe remains healthy. A strong dollar reduced this currency translation tailwind, especially in Latin America and Europe. As reported, constant dollar cross-border volume growth decelerated one percentage point from 11% in Q2 to 10% in Q3.

As a reminder, both Q2 and Q3 of fiscal year 2018 are impacted by lapping a settlement delay in Europe last year. This contributed 1 percentage point to cross-border growth in the second quarter and reduced growth by the same amount in the third quarter.

In addition, we have fully lapped the drag from an e-commerce payments platform shifting acquiring of UK cardholder volumes to the UK from another EU location. This reduced cross-border growth by over 2 percentage points in the second quarter and did not have an impact on the third quarter's growth.

The impact of each of these items on net revenue was de minimis. Both U.S. and Europe outbound commerce growth are down from their peaks, but continue at double-digits. Inbound commerce into the U.S. remained at double-digit growth rates, but decelerated with the strengthening of the U.S. dollar.

Europe inbound commerce growth also slowed but remained at double-digit levels adjusted for the settlement impact. Inbound commerce into Russia accelerated with the FIFA World Cup. Mexico and the Caribbean benefited from the continued recovery in tourism.

Cross-border growth was also strong across the Middle East and North Africa. The sharp weakening of currencies relative to the dollar significantly slowed outbound commerce into Latin America.

Processed transactions grew a healthy 12% for the third quarter in a row. Through July 21, U.S. payments volumes are up 11%, constant dollar cross-border volumes also grew 11%, and processed transactions grew 13%.

Turning to financial results, net revenue growth accelerated to 15%, service revenue grew 13%, data processing revenues were up 19%. International revenue increased 16%. Data processing and international revenues benefited from pricing, which went into effect this quarter. The currency translation benefit was lower this quarter versus the second quarter due to a stronger dollar.

While client incentive as a percent of gross revenue increased from 20.3% in Q2 to 20.8% in Q3, they were lower than we expected again this quarter. This was driven by lower than forecast incentive, as well as some contract signing delays. These delayed contract signings are expected to shift into the fourth quarter. As compared with the third quarter of fiscal year 2017, client incentives were up 20%, as many of the contract conversions in Europe were completed during the fourth quarter of fiscal 2017.

As reported on a GAAP basis, operating expenses grew 53%. Adjusted to exclude the special item related to the MDL provision, operating expenses grew 14%, primarily driven by personnel costs and marketing.

Headcount was still ramping up in the third quarter of the last fiscal year, following our global restructuring. This year-over-year increase reflects continued investment in personnel focused on our key growth initiatives.

Similar to the second quarter, this quarter also reflects the increase in our 401(k) matching contribution for U.S. employees, and higher employee incentive accruals tied to better than expected year-to-date performance. Marketing investment was higher than last year due to spending around the FIFA World Cup in Russia.

Finally, exchange rate shifts added 1 percentage point to expense growth. Non-operating expense was 34% lower than the third quarter of fiscal year 2017, driven by higher interest income on our cash balances, as well as a gain on the sale of an investment.

Our GAAP effective tax rate for the quarter was 17.2%. Excluding the $137 million tax benefit related to the MDL litigation provision, our adjusted effective tax rate was 18.2%. This includes a 6 percentage point reduction related to U.S. tax reform, and a 2.4 percentage point benefit from a non-recurring audit settlement.

Europe continues to exceed our financial expectations once again this year and relative to the original acquisition model. We now expect accretion from the Visa Europe acquisition to be at double-digit levels in fiscal year 2018. This exceeds our original acquisition expectations, and it's two years ahead of schedule.

The integration phase is nearing completion, also well ahead of schedule. As Al indicated, the complex process of converting clients to commercial agreements is complete, and the technology integration is on track for completion by the end of this calendar year.

With the integration phase complete, we're entering growth phase. We have many attractive opportunities for growth across Europe as Al described.

With that, our outlook for fiscal year 2018. There is no change to our outlook for net revenue growth, operating expense growth, and operating margin. As a reminder, we expect net revenue growth to be in the low double-digits on a nominal dollar basis, including approximately 1 percentage point of positive foreign currency impact.

Given that the weakening of the dollar accelerated starting in the fourth quarter of fiscal 2017, the exchange rate tailwind moderates in the fourth quarter of this fiscal year. At current exchange rates, the currency translation impact on the fourth quarter net revenues is neutral.

We expect to be at the low end of the 21.5% to 22% range for incentives as a percent of gross revenue. In the fourth quarter, client incentives are expected to be above the range due to the delayed contract signings.

As we discussed last quarter, full-year operating expense growth is forecast to be in the low double-digits adjusted for special items in both fiscal 2017 and fiscal 2018. Since investments ramped during the fourth quarter of 2017, we expect expense growth to moderate to the mid-single-digit range in the fourth quarter.

Our adjusted tax rate including the impact of U.S. tax reform is expected to be between 20.5% and 21.5%. This lower range reflects the tax rate realized year-to-date and includes non-recurring benefits from our tax initiative of 1 to 1.5 percentage points this year.

We also had a 6 point reduction from U.S. tax reform. In fiscal year 2019, we will lose the non-recurring tax benefits, but gain 1 to 2 points from a full year of the new U.S. federal tax rate. On a GAAP nominal dollar basis, we expect EPS growth in the high 50s. On an adjusted non-GAAP nominal dollar basis, we are increasing our EPS growth outlook from the high 20s to the low 30s. This includes 1.5 percentage points of positive foreign currency impact and 9 to 10 percentage point benefit from the impact of U.S. tax reform.

As a reminder, we will adopt the new revenue recognition standard at the beginning of fiscal year 2019. If applied to fiscal year 2018 reported results, we expect the impact of the new standard would be a reduction in reported net revenue growth of approximately 50 to 60 basis points. This impact is partially dependent on the terms of new incentive deals executed in the fourth quarter and going forward and therefore will vary.

At this point, we estimate that the application of the new revenue standard may be a modest headwind in fiscal year 2019 and approximately 50 to 60 basis points reduction in reported net revenue growth. We will continue to assess the impact on fiscal year 2019, and we'll provide an update when we discuss our outlook in October. As a reminder, the new accounting standard has no impact on cash flows or the economic value of our business.

In summary, business trends remained strong globally. Revenue growth has continued to accelerate. Bolstered by successful tax initiatives and U.S. tax reform, our fiscal year 2018 outlook anticipates adjusted EPS growth in the low 30% range. This will result in adjusted EPS being up over 60% since the end of fiscal year 2016. The Europe acquisition continues to track ahead of expectations, driving double-digit accretion by the end of the second year well ahead of schedule. As Al described, we're making good progress on a broad range of initiatives that are laying the groundwork to sustain high levels of secular growth into the future.

With that, I'll turn the call back to Mike.

Mike Milotich {BIO 20581476 <GO>}

Thank you. And with that, Katie, we are ready to take questions.

Q&A

Operator

Thank you. Our first question today comes from Sanjay Sakhrani with KBW. Your line is open.

Q - Sanjay Sakhrani {BIO 7390132 <GO>}

Thanks. Al, you talked about increasing the yield – the increasing yield part of the upside in Europe from those three sources. Could you maybe dimensionalize the runway versus where we are today? And then just a clarification, Vasant, on the data processing revenue pricing change, did that happen at the early part of this quarter? And was it a specific region, or was it across the board? Thanks.

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

Sanjay, we, as I think you know, typically don't get into the specifics on pricing. But I would just remind you that Visa Europe, until recently had operated as an association and therefore had different motivation. So, we have said before that we think that there is real pricing opportunity as we look at Europe over the next number of years. And we've started to take some of that pricing and we'll continue to over time.

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

On the data processing side, yeah, we did indicate to you, when we provided our outlook for this fiscal year, that the pricing this fiscal year would be in the second half of the year. So, most of the price increases around the world were effective April 1, and that's why you're seeing some of the impact starting this quarter. And we generally don't get into which region we took pricing in or how much and so on as you know.

A - Mike Milotich {BIO 20581476 <GO>}

Next question, Katie.

Operator

Our next question comes from Harshita Rawat with Bernstein. Your line is now open.

Q - Harshita Rawat {BIO 18652811 <GO>}

Hi, good afternoon. Thank you for taking my question. Al and Vasant, I want to ask a question about India, which, in many ways, has become the next place to watch in payments. And as you know, there's a lot happening on the ground with local players, Internet giants and government-backed schemes. So my question for you is, what's your strategy to gain traction in this extremely competitive market, especially versus some very nimble local players and also local schemes, which have certain advantages?

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

Well, thank you for giving us the opportunity to talk about India. I mean, we're very pleased with what's happening in India. The cash disbursement opportunity is great. I'd remind everybody that we are the market leader in India. We're well-positioned. We have greater than 50% share in India. We're continuing to grow at very healthy clips in 2018, and that's growing over very, very high growth in the prior year of 2017.

Our total focus is on growth, and the enablers of that are driving acceptance and driving innovation in the market. We're scaling QR code acceptance. We're partnering with issuers on driving awareness and usage, and we're working with issuers on things like tokenization, contactless, and scan and pay (sic) [scan to pay].

There's no question that India is a market where there is a number of competitors who have come into the space, but it is also a market that is in very, very early stages of its maturation in payments. And we believe that having been in India now for over 30 years and our various capabilities that we are well-positioned to get more than our fair share of growth as India matures over the next years, and frankly, decade plus. So we feel very good about it.

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

Yeah, a few other things to add in terms of the competitors. Clearly, with some of the players now becoming payment banks, it changes the nature of the relationship we can have with them. Payment banks can do issuance of debit cards and prepaid cards. But they're not allowed to issue credit cards, but they can use debit and prepaid.

And a lot of people don't like to load wallets if they can just use a debit or prepaid card, far more convenient. So it's not – you shouldn't be surprised to see partnerships emerge with people that you might have thought of as competitors, because there's mutual benefit in that.

There's also the opportunity to have acquiring licenses granted to some of the payment banks, which opens up a large amount of acceptance that has been built over time in a proprietary kind of way. Similarly, with some of the other entrants, what everybody is doing is essentially creating the pay electronically habit, which is good for all of us. The rising tide lifts all boats, so there's generally benefit as you can see that our business is also growing at a very healthy clip.

So all in all, I mean, as Al said, it's very early days, and there would be a variety of new partnerships formed. We are talking to a whole range of players. And we would say you should stay tuned as things develop.

A - Mike Milotich {BIO 20581476 <GO>}

Next question.

Operator

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

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

Hi, guys. Saw the results. Just want to ask about the incentives. I guess, one of the comments about incentives coming in lower than expected was a lower forecast. So just trying to figure if that was lower volumes coming from clients, or was there something in the forecast that's changed when we think about it going forward?

And in the fourth quarter, does that become the kind of the high watermark in kind of looking at seasonally for incentives typically, so we should see as a percentage of revenue – of gross revenue that the incentives in the fourth quarter becomes kind of the highest percentage and then it kind of drops from there? Thanks.

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

So two different questions. So on the first one, yes, the incentives coming in lower, a piece of it was clearly real reductions in incentives, i.e., incentives being lower than we expected. And that was because the incentive spend was not at levels – we make a bunch of assumptions when we do these things as to what we might need to do from an incentive standpoint.

And in this case, that was a real reduction from what we expected, and therefore we are saying, for the full year for example, we now expect incentives as a percent of gross revenues to actually be at the low end of the range that we gave you last quarter, we narrowed the range this quarter, we're saying it will be at the low end of the range, because incentives are actually coming in lower than we had forecast when we gave you our outlook last year. So that's a real reduction, it's not a delay.

In terms of the fourth quarter being high watermark, last year, the fourth quarter number was the high watermark, because we were doing this big conversion from rebates to incentives in Europe. And just based on historical trends in Europe, a lot of the deals bought down towards the end of our fiscal year. And so they were high in the fourth quarter.

This year again, we will probably have incentives being higher as a percent of gross revenue in the fourth quarter. I don't think you should view that as some kind of seasonality, it's just a reflection of what happened in the past couple of years, and just there timing was for renewal of certain deals and exactly what was going on in Europe and so on. So, I don't think you should carry that forward as sort of something that would happen every year.

A - Mike Milotich {BIO 20581476 <GO>}

Next question.

Operator

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

Q - Daniel R. Perlin {BIO 20452045 <GO>}

Thanks. So I just had a question on this pivot to growth for you guys in Europe, and in particular, around some of the market share commentary, Al, you mentioned. Can you give us a flavor, at least some idea about what you're thinking in terms of target markets? And do those markets look more debit-centric, credit-centric? Should we be concerned about what that could do to yields as you start to make that pivot? And are there any real large sizable buckets that we could start thinking through in terms of investment as you make that pivot? Thank you.

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

Well, Dan, I'd say a couple things. I don't want to necessarily give away many, many details of our specific strategies. But, look, our business in – the business that we bought in Europe is obviously very concentrated in the UK and a few other markets and has 37 markets as we look at it in Europe.

It's also largely what we inherited was actually a debit business. And so I think as we look at pivoting now off of the integration work that has been really dominating a lot of time and management attention over the last two years to really look at growth, I think that looking at other markets beyond the UK and France and Spain, and markets like the Nordics, markets like Germany, markets like Italy, and looking at moving beyond debit to credit are very high on our list. I think additionally, we think there's the possibility to pick up some processing capabilities, where – pick up some processing where our capabilities might be better and richer than some of the offerings in the markets around Europe today.

I think as we think about some of our capabilities that we'll be able to deliver once we're fully migrated over to VisaNet and our ability to introduce the capabilities that exist on VisaNet ranging from risk capabilities to fraud capabilities to tokenization, et cetera, I think there's a great opportunity in the continent of Europe in various pockets to pick up volumes. So that's where I would say that we're looking at putting our investments, Dan.

A - Mike Milotich {BIO 20581476 <GO>}

Next question.

Operator

Our next question comes from Tien-Tsin Huang with J.P. Morgan. Your line is now open.

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

Thanks. I'm glad to see the revenue acceleration here. I wanted to ask on Europe, just kind of a follow-on to Dan's question. Just now that you're ahead of schedule, two years ahead of schedule, has your total synergy expectation changed at all for Visa Europe? And is there anything to consider with Brexit and some other factors? I know there are some market review of a card acquiring business, I know that's not directly impactful to you, but anything we should consider today on Europe? Thanks.

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

Well, I'll let Vasant comment on the accretion. You know Tien-Tsin, we've looked at Brexit from any number of ways, and it's still unsure exactly where and how it's going to play out, as we all know, the politics in the UK right now is maybe not quite as interesting as the politics in the U.S., but it's awfully close. And how that's going to play out, who knows, but our view is that we don't see a lot of impact on our business from Brexit. We'll continue to look at it. We looked at it a number of times in depth, but we don't really see anything that concerns us there.

Vasant, do you want to comment on the...

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

Yeah.

...accretion?

On the accretion side, as I indicated in the comments, we are at double-digits right now, so that's higher than what we thought we would achieve over a period of time. I think we said high single-digits over a four-year timeframe. So it's higher than what we expected, and it is faster. Some of it is driven by things – we were fairly conservative when we did the acquisition modeling. Certainly, we've had better outcomes on pricing, overall volume growths have been stronger than we expected.

In addition to that, we were able to do the tax restructuring, and that created some real value. We've generally achieved all the other benefits we thought from a cost standpoint. So on all those fronts, things have performed better than we expected, and these are all very sustainable and will continue for sure. And as Al said, we see additional opportunity for yield improvement, and we will have some additional cost savings as we finish the technology integration.

But as with everything else, once you get into a business you realize what other opportunities you have. So clearly, we'll be investing in some of the growth opportunities that Al talked about. We're clearly going to be beefing up, as Al has said before, resources that are more in market rather than based at our hub in London, and we'll be increasing our investment in driving some of the growth initiatives that Al mentioned.

So things do change, but we did want to sort of give you a clean look at what our accretion was at the end of year, too, when it's still possible to cleanly look at what the business could have been without Visa Europe and is with Visa Europe. As you go further down the road, it gets muddier because things change. A lot of things change. But right now, at least, it's clean enough to give you a point of view.

A - Mike Milotich {BIO 20581476 <GO>}

Next question?

Operator

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

Q - Lisa Dejong Ellis {BIO 18884048 <GO>}

Hi. Good afternoon, guys. I have a question about Visa Direct and the applicability of Visa Direct for consumer bill pay, given how large a component of e-commerce consumer bill pay is, and also it's been a primary use case for competitive networks like fast ACH, et cetera. You didn't mention in your comments about Visa Direct any specific partnerships related to bill pay, so I'm – would love just some color on what the hurdles are to using Visa Direct for like online bill pay. And do you see that use case emerging and potentially diminishing the competitive threat from fast ACH?

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

It's very much and a very important use case of Visa Direct. I think the only reason Al didn't mention it is because he was talking about some of the newer use cases. There are four core use cases that are driving Visa Direct volumes today. Certainly P2P, you're all familiar with that, that's a big one. Disbursements, we've talked a lot about that Disbursements of all kinds – healthcare, the gig economy, and so on. Bill pay is the third and really important use case, that's well underway. We're enabling a variety of bill pay merchants right now through Visa Direct. And then the fourth is faster payments to merchants. These are things like services that acquirers are offering merchants where they can get money faster than waiting for the normal settlement schedule. So those are four use cases that are driving Visa Direct as we speak. What we were talking about was some of the newer use cases that are being enabled in the future.

A - Mike Milotich {BIO 20581476 <GO>}

Next question?

Operator

Our next question comes from Dave Koning with Baird. Your line is now open.

Q - David J. Koning {BIO 7310416 <GO>}

Yeah. Hey, guys. Thanks. So I guess just on the international revenue, a really nice driver has been, just how the growth has been mid to high-teens despite constant currency cross-border volume only growing like 10%, 11%, or so. I'm wondering, is that gap sustainable with pricing and mix? Or with FX coming in a little bit, should those two kind of converge a little and grow more in line with each other?

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

I'd say a couple of things and Vasant can add. As I look at our business, Dave, over the next number of years, a lot of our – the bulk of our growth is going to come overseas, and it's something we're putting a lot of time and attention to. And I personally spent a lot of my personal time overseas. And so, I think we're going to continue to see us invest in these markets, the cash opportunity – cash displacement opportunity is great. Some of the things we – just talking about Visa Direct and some of the use cases, the geographic expansion of Visa Direct into a number of these markets is going to be extremely helpful in driving volume, as well as some of the capabilities that we will continue to introduce in these markets that might be a little bit further along in some cases in the U.S. So it's going to continue to be – our aim is for it to continue to be a real source of growth.

You also had a question on the delta between the revenue growth and the constant dollar volume growth, yeah, it's a little harder for you from the outside to understand the drivers of that difference, and the three broad areas that can cause a difference: one as you pointed out is FX and that's clearly helped in the last few quarters and it helped more last quarter than it did this quarter. As you know, the dollar strengthened, so the FX benefit was greater last quarter on the international revenues than it is this quarter, but it was still a benefit. The second is mix. So I wouldn't underestimate the importance of mix, which corridors are growing does matter, some corridors are higher yielding than others.

For example, our cross-border volume growth includes what we call intra-EU cross-border volume. Intra-EU cross-border volume, as you know, does not have economics very different than domestic volume within the EU; and therefore when that grows faster than let's say the rest of the cross-border business that can be a drag and vice versa. So mix is a factor, which is harder for you to see from the outside. And the third is of course pricing; and this quarter we had some benefit from pricing.

So there's three different factors and they have a – they interplay with each other. You're right, as we get in the fourth quarter as the FX benefit moderates a bit, that won't help as much just as it helped less in the third quarter, but then there are the other factors to consider, too, like pricing and mix.

A - Mike Milotich {BIO 20581476 <GO>}

Next question?

Operator

Our next question comes from Darrin Peller with Wolfe Research. Your line is now open.

Q - Darrin Peller {BIO 16385359 <GO>}

Thanks, guys. So I mean, you're trending better than the first quarters – few quarters, so other than higher incentives just to be clear, is there anything else limiting your ability on the top-line to raise? I think it's just incentives to be clear.

And then, Al, I mean, cross-border seems to be trending better than last year, obviously, in the double-digits again. I just want to hone in for a moment on the sustainability on that kind of trend in your mind just given e-comm is a higher percentage mix now. And if that should hold up in your view, and then if incentives as a percentage of that could be – basically incentives as a percentage of revenue should be lower with cross-border being stronger? Thanks, guys.

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

Well, I'll take the second part of your question. I think that – I don't want to be in the predicting business, but I will tell you this that we want to be making sure that cross-border is growing at as healthy of levels it possibly can and e-commerce is in fact an enabler to that.

I think as long as – and in addition to that, as long as the economies of the world stayed strong and we're seeing people feel comfortable about traveling, that's certainly also going to greatly contribute to cross-border continuing to grow. It's an area of real emphasis for us and real emphasis for the work we do with our issuer. So it's an area of great focus, and we expect it to hold up.

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

So on your other question about the revenue growth trajectory, I'll just repeat two things that I mentioned in my earlier remarks. One was in the fourth quarter – in the third quarter we had FX exchange rate tailwind of 1.5 percentage points, so it added 1.5 points to our net revenue growth. If you just take today's exchange rates and given that the dollar really started to weaken in the fourth quarter of last year, the FX impact on net revenue growth is close to neutral. So you do have that one change.

And then the other one you pointed out was incentives represent of gross revenue were 20.8% in Q3, and we said would be higher in the fourth quarter. So there are two factors that are different in the fourth quarter as we sit here today in terms of impacting the net revenue growth rate – the reported net revenue growth rate.

A - Mike Milotich {BIO 20581476 <GO>}

Next question?

Operator

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

Q - James Schneider {BIO 15753052 <GO>}

Good afternoon. Thanks for taking my question. Al, relative to some of the comments you made before about the various applications of Visa Direct all the way from remittance, P2P, bill pay and direct deposit for merchants, et cetera, as you project forward over the next few years, can you give us any kind of sense about, say, four or five years out, how big a piece of revenue or percentage of total company revenue those various opportunities could be collectively for you at that point?

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

Jim, we're not going to make forecast three to five years out on anything. I would say this though, that obviously we've been talking about Visa Direct for a little over a year or year-and-a-half now. We're actually starting to meaningfully see it in our numbers. You're continuing to hear us talk about it in bullish terms.

I think it's important to emphasize that this is an operational capability that exists today. It's global. It's a capability that's attracting partners to us to try to talk about different use cases. Visa Direct is running on our VisaNet platform, and therefore has all the associated speed, security and scale that's associated with it.

And VisaNet has the capability to provide a bunch of services that's a lot of other real-time payment networks don't, including things like dispute resolution, chargeback, risk and fraud tools. So when I look at the opportunity, what excites me about Visa Direct is: A, it's grounded in our core VisaNet platform, but it has multiple tentacles for growth, both geographic growth as well as growth in use cases and its – and segments. It's a capability that supports P2P, it supports B2C, it supports government to consumers, it supports small business to small business. So I think when you look at it as a capability that cuts across ability to grow via segments, grow via geography, grow via use case, it certainly is something, Jim, that we're excited about and continue to – and we'll continue to invest against.

A - Mike Milotich {BIO 20581476 <GO>}

We have time for one more question, Katie.

Operator

Our final question today comes from James Faucette with Morgan Stanley. Your line is now open.

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

Great. Thank you very much. I just wanted to quickly go back to a question that Tien-Tsin asked a few minutes ago and specifically on the UK review of some of the acquiring businesses. In that review it looked like they also said they may be looking at scheme fees, et cetera. Just wondering if you can help give a little light as to what you think they may be looking at, and kind of your discussions with that regulatory body as far as you've had them? Thanks.

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

James, this is very early. It's not unusual at all for the regulators in the UK to be looking at any and all aspects of payments. This particular piece is focused on acquirers; it's not focused on Visa. And I think it's safe to say that we will be watching it closely, certainly providing whatever support we need to provide to acquirers as they address any queries from the PSR in the UK.

But at the moment, again, this is just very early days and there's really nothing to report. There's no real clarity about what, if anything, they're specifically looking at. Sometimes these things open as just simple queries as to wanting to get information. And other times they result in action and sometimes they result in inaction, and we'll just got to watch this and see how it plays out, James.

A - Mike Milotich {BIO 20581476 <GO>}

And with that, we'd like to thank you for joining us today. If you have additional questions, please feel free to call or e-mail. Thanks again and have a great evening.

Operator

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