Q1 2018 Earnings Call

Company Participants

- Alfred F. Kelly, Chief Executive Officer & Director
- Joon Huh, Vice President, Investor Relations
- Vasant M. Prabhu, Executive Vice President & Chief Financial Officer

Other Participants

- Bryan C. Keane, Analyst
- Chris Brendler, Analyst
- Darrin Peller, Analyst
- David Mark Togut, Analyst
- James E. Faucette, Analyst
- James Schneider, Analyst
- Jason Kupferberg, Analyst
- Ramsey El-Assal, Analyst
- Sanjay Sakhrani, Analyst
- Thomas McCrohan, Analyst
- Tien-Tsin Huang, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome to Visa's fiscal first 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.

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

Joon Huh {BIO 20088238 <GO>}

Thanks, Athena. Good afternoon, everyone, and welcome to Visa Inc.'s fiscal first quarter 2018 earnings conference call. Joining us today are Al Kelly, Visa's Chief Executive Officer, and Vasant Prabhu, Visa's Chief Financial Officer.

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 slide 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 in our most recent reports on Forms 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, let me turn the call over to Al.

Alfred F. Kelly {BIO 2121459 <GO>}

Joon, thank you, and good afternoon to everybody and thanks for joining us today. As always, Vasant and I are going to make some relatively brief comments on the results, and then we'll open it up to whatever questions you have on your minds.

We're off to a solid start in our fiscal year, and I'm pleased with our company's performance this past quarter. Our performance was driven by healthy economies around the world, growth and acceptance and the continued rise in E&M commerce, especially in developed countries.

U.S. tax reform certainly has and will continue to impact our business in positive ways. We have made a few initial decisions about our investments as a direct result of the lower corporate tax rate, and we will continue to talk about and analyze additional incremental spending options to bolster our talent, our business, and the communities in which we work, all with the goal of fulfilling our corporate mission of helping individuals, businesses, and economies thrive.

Looking at our business drivers, payments volume grew 10% on a constant dollar basis, as we saw healthy growth around the globe. The Central Europe/Middle East region led the way with 19% growth, driven by the Gulf countries of the Middle East. Latin America was up 14%, with particular strength coming from Argentina. Canada grew 11%, up 4% sequentially, resulting from higher gas prices and increased spending in retail and telecom.

In the United States, payments volume grew 10%, driven by increases in consumer credit and holiday spending, which I'll spend a few minutes on a bit later. Europe maintained a solid growth rate of 9%, with strength coming from Turkey and Southeast Europe. And Asia-Pacific grew 8%, as we saw improved volumes from Australia and Taiwan. And although we're partially lapping the demonetization in India, total processed transactions continued to grow at a double-digit rate of 12%.

Turning to the financial metrics, net revenue grew 9%, driven in part by a strong holiday season and accelerating e-commerce growth. We saw good momentum in our cross-border business, with revenue growth of 12% and constant dollar volume growth of 9%. Despite the lapping of Brexit and a stronger currency dynamic, the European cross-border business performed better than we expected.

In the United States, we saw a sequential increase in cross-border growth, resulting from increased inbound activity as the dollar remained relatively weak throughout the quarter. And the weak dollar trend has continued into the first few weeks of this quarter.

Client incentives were 21.4% of gross revenue, roughly in line with the prior quarter. And as we discussed on the last call, we're making significant investments in our business initiatives and our strategic priorities, leading to increased expense levels in the quarter. And with the new U.S. tax reform in place, a portion of the benefit is reflected in our fiscal first quarter results. This all led to adjusted EPS growth of 26%, which includes the benefits from tax reform. Vasant will go into greater detail on the impact of tax reform and provide more background on the numbers.

Now let me provide some more color on the subject of U.S. holiday spending. The 2017 holiday season was stronger than the prior year, as both consumer credit and debit grew at higher levels. Growth was driven by better performance in retail and entertainment, which includes movies, gaming, fitness, sporting goods, recreational activities. Additionally, higher gas prices contributed to some of the growth.

Both offline and online volume had higher growth rates than the prior year, with online growing approximately four times faster than offline. During the holiday season, e-commerce continued to gain share, jumping to over 30% of consumer U.S. holiday volume. E-commerce growth was strong across a number of categories, but was most significantly strengthened by retail performance. Interestingly, the retail spending was stronger earlier in the holiday season. The couple of weeks prior to Thanksgiving and Thanksgiving week were quite a bit stronger than the growth we saw in the prior year.

Beyond the U.S., when we look at some of the other markets and their holiday seasons, growth was better than last year in Brazil, Australia, and Canada, and was essentially flat in the United Kingdom.

Turning to our business activity, we had another busy quarter for announcements. We are very pleased to expand our global leadership position in the co-brand arena with the launches of the Starbucks and Uber programs. Additionally, we renewed our strong and long-term partnership with Marriott. Additionally, we had a good pipeline of renewals across the world.

We also advanced our digital products. Most notably, we announced a partnership with Facebook in October, as they joined our Visa Digital Enablement program to use our Token Service to accelerate payment services on their digital properties. With this partnership, Visa cards used on Facebook Messenger will now be tokenized, and therefore the account numbers are not exposed. This partnership furthers our efforts to encrypt and devalue payment information in the payments ecosystem. Additionally, this partnership advances our efforts to enable and develop new digital commerce experiences, as consumers spend more time in messaging environments like Facebook's.

In November, we launched Visa Direct in Europe, which provides real-time push payment solutions for person-to-person, business-to-business, and business-to-consumer applications, leveraging our global network. The advantage of Visa Direct is that it utilizes our existing network connections, rules, operations, and key controls that are built into the network, such as transaction limits and sanctions screening. Because of this technical and operational leverage, the time and cost of implementation is lower than many alternative options. As we stated previously, we believe that Visa Direct is a key product to enable fast payments across Europe.

More recently, we initiated a small pilot for new biometric cards for contactless payments, which provides an alternative to PIN or signature authentication. This is the first commercial pilot to test a non-card biometric for contactless payments. We're committed to ensuring secure, fast, and convenient payments at the point of sale. And core to delivering on this commitment is to continually evolve the marketplace in terms of dynamic authentication methods such as EMV chip and, in the case of these pilots, investing in emerging capabilities that leverage biometrics.

As we stated before, we always want to make strategic investments that will drive long-term growth for our business. With that objective, we're making investments in the area of contactless transactions and authentication methods, as this is the natural evolution following the adoption of the EMV infrastructure. Consumer research and internal data have shown that there's a strong interest for contactless payments, as it creates a faster and more convenient experience at the point of sale. We've seen significant adoption in markets like Australia, UK, and Canada, and we hope to increase adoption in other markets. We're especially excited about the U.S. market, given the build-out of the EMV infrastructure that will allow us to move the market forward and towards contactless transactions.

Echoing my earlier remarks, the recent tax reform will create benefits and opportunities for our business. We're exploring a range of options, and we're prioritizing long-term sustainable investments versus one-time actions.

One of the areas we're most focused on is our employees and talent development, as this is the foundation of our business. As a first step, we enhanced our benefits for U.S.-based employees and increased our company contribution to the U.S. 401(k) program, given the importance of retirement planning. This allows U.S. employees to enjoy a sustained benefit consistent with the ongoing contributions that they make every day to build our business for our clients, partners, and shareholders.

Additionally, we're exploring other global benefits and investments for our business around the world. Throughout the year, we will continue to make strategic investments in our people and in the areas of digital products, technology operations, and merchant solutions, as we position the company for long-term sustainable growth.

Additionally, in light of tax reform, the board increased the quarterly cash dividend to $0.21 per share. Ultimately using funds to grow our business organically, however, is the top objective for our capital allocation here at Visa.

Last year, we evolved our global social impact strategy and announced the formation of the Visa Foundation. Funds available through the foundation will help drive real progress across the world, with a primary focus on helping micro and small enterprises thrive through access, growth, and resilience. I'm pleased to say that the foundation made an inaugural grant this past quarter to the Women's World Banking. This grant will help support the millions of women-led small and micro enterprises, which are underserved financially around the world.

Let me spend a few minutes on the international front. In Europe, we are making good progress on our ongoing integration efforts and identifying areas for growth. We're working closely with our clients, as we've now resolved over 80% of the contracts moving to commercial incentives.

In terms of the technical integration, we expect the VisaNet migration to begin this quarter and continue throughout 2018. We have planned carefully with our clients to ensure the highest standards of preparation and testing for the months leading up to the migration, with regular updates with the business leaders to ensure a smooth and stable migration. Once the migration is completed, we'll be able to deliver new products, services, and capabilities to the region, bringing the best of our global capabilities to our European clients.

As I mentioned on the last call, I was going to spend additional time with the European leadership team in planning and strategy meetings this past quarter. Having spent three of the last six weeks in Europe reinforced my belief that there is still meaningful growth opportunity in the region.

A few remarks about India, we have a market-leading position in debit and credit, with significant share in both categories. After partially lapping the impact of demonetization, we saw domestic payments volume grow over 20% and processed transactions grow 12% in the past quarter. We continue to engage with the regulators, the government, and our clients to ensure sustainability of the economics, and we are investing and partnering with issuers, acquirers, and the government to grow electronic payments. We have crossed 3 million acceptance points and are working to scale up contactless and broad QR usage and acceptance points.

As we look at our capital allocation plans, our top priority, as I said earlier, continues to be investing for the future growth of our business to deliver shareholder value. In addition, though, we remain committed to returning capital to our shareholders. In fiscal Q1, we returned $2.2 billion of capital, consisting of $1.7 billion in share repurchases and nearly $460 million in dividends. As I stated on our last call, we expect to return over $9 billion of capital to shareholders this fiscal year. I already talked about the dividend increase to $0.21 per share. The board on Tuesday also authorized an additional $7.5 billion share repurchase program, resulting in a current authorization level of $9.1 billion.

In closing, we're off to a solid start to our fiscal year. I'm pleased with our consistent business execution and excited about the many growth prospects ahead.

And with that, let me turn it over to Vasant, who will cover some of the financial details.

Vasant M. Prabhu {BIO 1958035 <GO>}

Thank you, Al.

We had a solid start to fiscal year 2018, with GAAP EPS growth of 25% and adjusted EPS growth of 26%. Implementation of the Tax Cuts and Jobs Act added approximately 9 percentage points to this adjusted growth rate, which I will discuss in more detail in a few minutes. Excluding the impact of U.S. tax reform, EPS growth was 17%. Net revenue growth was 9%. Growth of key business drivers, payments volume, cross-border volume, and processed transactions, remain strong and stable across the globe.

As a reminder, several significant factors have a meaningful impact on year-over-year revenue growth comparisons this quarter. First and by far the most significant factor, rebates to Visa Europe members ended beginning in the first quarter of fiscal year 2017 ,so this is the first quarter of apples-to-apples revenue growth comparisons for Europe. This affects reported service fees, data processing, and international revenue. We are also at apples-to-apples growth comparisons for Costco and USAA credit.

The India demonetization impact started in November 2016, so we partially lapped that in Q1. And finally, fiscal year 2018 price increases, which are smaller in scope than fiscal year 2017 increases, will go into effect in the second half of the year. In fiscal year 2017, our U.S. price increase went into effect in the first quarter, and international increases went into effect mostly in the second quarter.

A few other items of note, we bought back 15.5 million shares of Class A common stock at an average price of $110.67, for $1.72 billion this quarter. Our board has authorized a new $7.5 billion share repurchase program. Including this additional authorization, we now have $9.1 billion available for share repurchases.

In addition, our board has increased the quarterly dividend to $0.21 per share, an almost 8% increase, commensurate with the higher earnings potential of the company post-tax reform. This is in addition to the 18% increase in the dividend last quarter.

Finally, in October 2017, we used the proceeds from our September debt offering to redeem the $1.75 billion of senior notes scheduled to mature in December 2017.

A quick review of the key business drivers in the fiscal first quarter, payments volume on a constant dollar basis grew 10%. Even the growth from Costco and USAA credit on an apples-to-apples basis, U.S. growth accelerated 1 point, increasing from 9% in the fourth quarter to 10% in the first quarter. This reflects solid underlying growth from a strong holiday season, particularly in the credit business. Credit was up 11%. Debit was up 8%. Adjusted for conversions, underlying growth rates for both credit and debit stepped up.

As Al described, we saw higher growth in consumer payments volume this holiday season, driven by acceleration in retail and entertainment spending, especially online, as well as rising gas prices.

International payments volume growth in constant dollars was stable at 10%. Growth rates stepped up in Canada, Australia, across Latin America and the Middle East. The rate of decline in Chinese dual-branded card volume slowed. This was offset to some extent by the impact of lapping India demonetization.

Cross-border volume on a constant dollar basis grew 9%. This is 1 point lower than the fourth quarter of fiscal 2017, primarily due to the drag from an e-commerce payments platform shifting acquiring of UK cardholder volume to the UK from another EU location. The total impact of this shift, which we first mentioned in July, is a greater than 3-point reduction in our reported cross-border constant dollar growth rate. This shift has only a minor effect on revenue since it is an intra-EU move the platform made to optimize its European business.

U.S. outbound spend also slowed moderately as the dollar weakened. As we expected, growth of inbound commerce into the U.S. picked up with the weakening dollar. Inbound commerce into Europe remained robust, but growth slowed as we lapped both the weakening of both the pound and euro after the Brexit vote.

Growth in outbound spend from the Caribbean has returned to more typical levels after the hurricanes. However, inbound spend remains weak as travelers choose other destinations while many of the islands recover.

Processed transaction growth of 12% is down 1 percentage point versus last quarter, largely driven by partially lapping India demonetization.

Through January 28, constant dollar U.S. payments volume growth was 9%, U.S. credit growing 10% and debit 8%. Cross-border volume on a constant dollar basis was up 11%. Processed transactions grew 11%.

A brief review of fiscal first quarter financial results, net revenue grew 9%. As I mentioned earlier, net revenue growth deceleration versus the prior quarter is driven by several significant factors, particularly the removal of European rebates. Exchange rate shifts helped Q1 net revenue growth by around 1 point.

Incentives as a percent of gross revenue is at 21.4%, at the lower end of our outlook range this quarter but up 2.5 percentage points from last year, as Europe contract conversions and other renewals during the second half of fiscal year 2017 impact us in fiscal year 2018. We expect to see an uptick in incentives as a percentage of gross revenues in the remaining quarters based on the timing of renewals.

We're on track to complete the conversion of contracts in Europe from rebates to incentives by the end of the second quarter.

Operating expenses grew 13%, primarily driven by personnel costs. As a reminder, personnel expenses were low in the first quarter of fiscal year 2017 and ramped up through the year. We have some expenses that are first-half loaded, including the Winter Olympics in the second quarter as well as Europe integration costs, as we complete the technology platform harmonization and start client migrations.

Our spend rate on investment initiatives is higher in the first half of fiscal year 2018 than they were during the first half last year, since we ramped up many of these investments during the second half of fiscal year 2017. In addition, the first quarter of fiscal year 2018 operating expenses were higher than we expected due to some timing shifts and some non-recurring items.

Non-operating expenses are lower than expected due to higher interest income on our cash balances as well as a gain on the sale of an investment.

Our tax rate for the quarter on a GAAP basis was 22.1%. This included two special items related to the implementation of U.S. tax reform. First, we had a $1.13 billion one-time non-cash tax benefit from remeasuring our net deferred tax liabilities based on the new corporate tax rate.

Second, we had an offsetting $1.15 billion charge related to the transition tax. In moving to the new territorial system, the Tax Act requires a transition tax on previously untaxed deferred foreign income. This tax, which is payable over eight years, is 15.5% on the amounts held in cash and cash equivalents and 8% on the remaining non-cash amount. These two items are estimated based on the information available to us at this time and may be adjusted over the year as we analyze additional information and guidance.

Adjusted to exclude these two items, our effective tax rate was 21.7%. Both the GAAP and adjusted tax rates were six percentage points lower because of the lower corporate tax rate. Implementation of the Tax Act added $0.07 to our GAAP EPS and $0.08 to our adjusted EPS in the first quarter. This translates to 9 percentage points of additional EPS growth. Exchange rate shifts added 1 point to reported EPS growth.

With that, I'll move to our updated outlook. We are revising our fiscal year 2018 outlook for the impact of U.S. tax reform. Let me briefly start with what is not changing. Annual net revenue growth is still expected to be in the high single digits on a nominal dollar basis. This includes 0.5 to 1 percentage point of positive foreign currency impact. The impact of the U.S. dollar strengthening relative to the Japanese yen, the Brazilian real, and the Mexican peso is offset by the impact of the U.S. dollar weakening relative to the euro and the pound. The quarterly cadence of revenue growth remains unchanged versus our prior expectations.

Our outlook for the fiscal second quarter net revenue growth remains a couple of points below the full-year rate. We also reiterate our outlook for client incentives as a percent of gross revenues in the 21.5% to 22.5% range and annual operating margin in the high 60s.

Now to what is changing, our GAAP and effective tax rate is expected to be 6 points lower or approximately 23% for fiscal year 2018. This is driven by the reduction of the U.S. federal tax rate on our U.S. taxable income from 35% to 21%. This benefit from the reduction in the federal tax rate is partially offset by deductions that are no longer available and the lower benefit for state taxes paid.

The 6 percentage point reduction of our fiscal year 2018 tax rate represents three quarters of the lower U.S. federal tax rate starting January 1, 2018, through the end of our fiscal year in September. The annualized reduction in our tax rate is 8 percentage points. As such, we will have another 2-point reduction in our overall tax rate in fiscal year 2019.

The tax reduction will be partially offset by new provisions of the Tax Cuts and Jobs Act that go into effect in 2019 such as the repeal of Section 199 deductions, the 13.1% floor on global intangible low-taxed income, as well as the Base Erosion and Anti-Abuse Tax. We'll be doing the work to assess the impact of these provisions over the next few months and update you as we have better estimates. At this point, we expect an additional 1 to 2 percentage point reduction in our fiscal year 2019 tax rate over and above the 6 percentage point benefit we realized in fiscal year 2018 as a result of U.S. tax reform.

We plan to reinvest approximately 1 percentage point of pre-tax earnings in our business and our people. Al mentioned the change we made to our 401(k) matching contributions to U.S. employees. We are evaluating additional investments, with a focus on actions that will drive long-term sustainable revenue growth. We anticipate that this additional investment will increase our operating expense growth in fiscal year 2018 by approximately 2 percentage points to the high end of mid-single digits adjusted for special items in fiscal year 2017.

We are still expecting operating expense growth to be higher in the first half and lower during the second half for all of the reasons we discussed previously. Double-digit growth in operating expenses is expected to continue into the second fiscal quarter.

The impact of these changes on our EPS outlook for fiscal year 2018 is approximately 9 to 10 points. We now expect EPS growth to be at the high end of the mid-20s range on an adjusted non-GAAP nominal dollar basis. This still includes 1 to 1.5 points of positive foreign currency translation impact.

We project adjusted free cash flow to be approximately $10 billion, up $900 million from what we estimated last quarter. This is largely driven by U.S. tax reform.

Our quarterly dividend at $0.21 is 27% higher than our fiscal year 2017 quarterly dividend. We have over $9 billion available for stock buybacks. We continue to anticipate buying back over $7 billion of Visa stock during fiscal year 2018.

We ended the quarter with global cash on hand, including marketable securities, of $14.1 billion, of which $6.3 billion is currently offshore. During the quarter, we returned $1.8 billion of non-U.S. cash back to the U.S. We are working on additional actions to further reduce our offshore cash in fiscal year 2018.

As a reminder, we will adopt the new revenue recognition standard on October 1, 2018, the beginning of our fiscal 2019. If applied to the first quarter fiscal year 2018 reported results, the impact of the new standard would have been small. The impact to fiscal year 2019 is partially dependent on the terms of new incentive deals executed and will therefore vary. We will continue to assess the impact of the new standard throughout fiscal year 2018 and provide an update if we believe that the application of the new standard to new deals in aggregate will 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, fiscal year 2018 is off to a strong start, underpinned by a healthy global economic environment. The shift away from cash to digital forms of payments remains a powerful secular trend. Europe performance and integration plans remain on track. Our outlook for operating performance remains unchanged. Tax reform in the U.S. will add 9 to 10 points to EPS growth after the additional investments we're planning.

We remain committed to our stated capital allocation strategies. Our board has raised the quarterly dividend again this quarter to reflect the higher earnings potential of Visa post-tax reform, and we have over $9 billion in authorizations to fund our stock buyback plans.

With that, I will turn this back to Joon.

Joon Huh {BIO 20088238 <GO>}

And with that, Athena, we are ready to take questions.

Q&A

Operator

Thank you. Our first question will be from the line of Tien-Tsin Huang of JPMorgan. Sir, your line is now open.

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

Thank you, good afternoon. I thought I'd ask on U.S. debit. It looks like growth has settled in pretty nicely actually, around 8% the last two quarters. Is this a good clean rate to assume for U.S. debit as we look ahead?

And I also wanted to – I've been meaning to ask you guys. Since your decision to no longer require a signature checkout in the U.S., what's the opportunity there? How does this change the dynamic of PIN versus signature and all that good stuff? Any thoughts there would be helpful. Okay, thanks.

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

Hi, Tien-Tsin. Thanks for your question. So on the first question, obviously we're not going to forecast ahead, but U.S. debit has been performing quite well. And as I said in my remarks, debit as well as credit looked very good in the holiday season.

In terms of your second question, the reality is that the vast majority of transactions in the United States didn't require a signature anyway because of the number – especially in debit because of the requirements of not having to take signature for under $25 or under $50 for a transaction.

Our decision, which we took a very thoughtful approach to, ended up being at least a little bit different than our competitors, where we said that we're going to move to no signature where somebody is set up for EMV. We actually think we need to continue to encourage adoption of EMV for security reasons, and therefore made the requirement that it's no signature as long as your merchant is EMV-enabled. And we continue to believe that we've got a good roadmap for debit, but I would say these things are unrelated largely. And the reality is that we think we made a good decision for consumers.

I'd also add that I still think there's a place for signature in a number of cases. High-ticket items, I think as we've done a lot of consumer research, consumers want to be able to validate and merchants want to be able to validate that transaction. Also, consumers in situations like tipping situations where they're adding to the base amount also prefer to be able to continue to use a signature. So while there's no signature required, we do expect that a number of merchants in specific situations will continue to request a signature from consumers and consumers will want to provide that signature.

A - Joon Huh {BIO 20088238 <GO>}

Next question, please.

Operator

Thank you. Your next question will be from the line of David Togut of Evercore. Sir, your line is now open.

Q - David Mark Togut {BIO 1496355 <GO>}

Thanks, good afternoon. Could you update us on your strategy to expand Visa Europe into some of the higher growth markets where you're less well represented, for example, Nordics, Italy, and Germany?

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

As I said in my remarks, I've been over there three of the last six weeks. And I think that we have largely built out our leadership team and are very far along on the strategy for

Europe. And you're absolutely right, David. If you look at our business in Europe, obviously we have a very strong position in the UK, in France. We have a good position in Spain, but there are 34 other markets in Europe, at least the way we establish Europe, and there's a lot of opportunity in the markets.

You mentioned plus Italy, plus Germany, and we're in the midst of actually staffing up in a number of markets in terms of personnel. One of my objectives is to ultimately have less people in the regional hub in London and more people out in the markets where the action is. But between bringing our digital products into Europe, Visa Direct, Visa Token Services, as well as adding personnel and building our relationship with issuers, Charlotte Hogg, our new European CEO, has spent a tremendous amount of time in the four months she's been with the company out talking to our clients throughout Europe.

So I absolutely believe that Europe, particularly on the continent, represents great opportunity for us, and we're at the beginnings of what will be a journey to build our business to a much stronger position on the continent.

Q - David Mark Togut {BIO 1496355 <GO>}

Thanks.

A - Joon Huh {BIO 20088238 <GO>}

Next question – go ahead.

Q - David Mark Togut {BIO 1496355 <GO>}

Just as a quick follow-up, you mentioned launching Visa Direct in Europe. Can you talk about your broader strategy for PSD2? At Analyst Day, you mentioned keeping your options open, potentially buying a PSP. I'd be curious for what your thoughts are currently.

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

I think as we said then and I think we've been consistent. Look, PSD2 is a long-term play, and I think it's going to take a while to see how it's actually going to play out. We actually think we're pretty well positioned as it relates to PSD2 coming into Europe. The strong customer authentication is going to require and put a premium on risk and authorization capabilities, which is a strong point of ours. The whole ability to have third parties access accounts I think puts a premium on an outstanding payment experience, and that's something that we pride ourselves in working closely with our issuers are, and this probably new consumer experience is that will emerge as a result of the PSD2 legislation. And I think again, we feel like we're well positioned to work with our issuer partners on it.

So I think this is going to be a very slow build over time, but I think we feel like we're well positioned as it relates to this regulation going into place in Europe.

Q - David Mark Togut {BIO 1496355 <GO>}

Thank you.

A - Joon Huh {BIO 20088238 <GO>}

Next question, please.

Operator

Thank you. Your next question will be from the line of Darrin Peller of Barclays. Sir, your line is now open.

Q - Darrin Peller {BIO 16385359 <GO>}

Thanks, guys. Just starting off, it looks like there's around a $1 billion benefit from tax reform that you can see over the course of the year just based on the tax rates you're giving us now. I know you talked about some specific items like retirement contributions and investments in growth. I guess, a little more specifics on breaking down that dollar amount in terms of your expectation on categories along with the sustainability beyond this year.

And then, Al, just when you think about market share here, I'd just love to hear your thoughts on if there's a good pipeline of things up for grabs. Just looking at one of your biggest competitors, the growth profile of some of their volumetrics are still a little higher. I'm just curious if there's anything that you see happening, or is it just timing factors? Thanks.

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

There are two questions there. I can take the tax one, and then Al I'm sure will talk about the second question. On the tax one, just to go through it again, the full benefit of the reduction in the U.S. federal tax rate from 35% to 21% on an annualized basis is 8 points. You get 6 points this year because we're getting three quarters of benefit. We'll get 2 points from the corporate tax reduction next year. We're just being a little cautious on the 2 points because there are additional provisions that are going next year that we along with others are looking for more guidance on. We have an initial point of view on it, but we're assuming it will change through the year. As you know, when you translate that, that is a $1 billion after-tax benefit to us in lower cash taxes as a result of that.

There are two things – we can talk about four things around how we want to deploy the cash. One, you already heard us say that we've already made some decisions that we'll reinvest about a point of that reduction in taxes, meaning 1 point of our pre-tax income, in our business in operating expenses, some of which you already heard about, things we're doing for employees, others in terms of adding to some of the investment programs that are already on the way, as well as some new initiatives. That will cause our expenses to grow a little bit more than we had originally anticipated. Our expenses are essentially on track for the year versus prior outlook, where just there's a deliberate strategy increasing it by 2 points as a result of tax reform.

The second dimension is commensurate with the higher earnings potential of the company. We are stepping up the dividend. We already have a healthy buyback program with over $7 billion this year. This was reflecting the fact that we were buying back some of the stock issued to Visa Europe owners. Once we get past the $7 billion mark, if we need to do more, we will evaluate it at that point.

And then finally, in terms of M&A and investments, as Al said, our priority is to invest in our business organic growth. The fact the tax rates are lower certainly improves the ROI you can get on investments, and the same on M&A. But we were not cash constrained before, so we're not going to change our posture other than the fact that lower taxes make investments more attractive.

So I'm going to turn it back to Al, if he wants to add to this, and I'm sure he's going to talk about the other question.

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

No. Look, we're not the type of company that can deploy capital organically extraordinarily quickly, but we've got a whole set of key investment areas that are driven off of our strategic pillars, and we're going to continue to focus on those things. Whether it's security in the ecosystem, driving contactless, expanding access, digital expansion, those will be the areas we focus on.

Darrin, in relationship to your second question on market share, I would say this. In my mind, there's tremendous opportunity to grow in the medium and long term. And I think the opportunity is bigger in just growing the market, bringing more people into the payments mainstream, expanding access, displacing cash and check.

I think we've had a very good quarter. Mastercard had an excellent quarter. To me, this isn't a quarter-by-quarter contest. We're driven and focused on sustained long-term growth for our investors over time. And I'd also point out that I think looking at quarter-by-quarter comparisons can be really tricky. There's a whole bunch of factors that are different between us and some of our competitors. There are business mix differences. There are lapping dynamics. There are timing issues. There are wins and renewals and conversions and, frankly, this differential impact of exchange rates. So I look at it and say I think the medium to long-term opportunities are terrific. I think our fundamentals are very good, and we feel good about the long-term prospects of the business.

Q - Darrin Peller {BIO 16385359 <GO>}

Okay, that makes sense. Thanks, guys.

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

Thank you.

A - Joon Huh {BIO 20088238 <GO>}

Next question, please.

Operator

Thank you. Your next question will be from the line of Jim Schneider of Goldman Sachs. Sir, your line is now open.

Q - James Schneider {BIO 15753052 <GO>}

Thanks for taking my question. Maybe going back to the Europe topic for a second, if you think about your market share position within Europe across both debit and credit, Al, can you maybe opine on where you see opportunity to improve that position in terms of individual countries? And then as you think longer term, do you think that could come at the expense of local processors or more your traditional peers?

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

Jim, at this stage, I'm reluctant to get into – for competitive reasons, get into specific places that we might focus on because there's quite a few places we could go, and we haven't even 100% finalized our plans, but we are quite far along. Obviously, I think that there are a number of places as I look at it. One is there are markets where frankly the biggest competitor is cash. And the top of mind there is Germany, which remains an enormously cash-driven society and frankly a very fragmented banking environment and infrastructure.

So I think in some cases, it's figuring out how to really drive people away from cash, and I think e-commerce becomes a stimulant for training people that using their credit card is a good, safe way to transact. In some cases, it will be looking to compete heavily with our more traditional competitors. And thirdly, obviously there's a number of domestic processors and, in some cases, schemes throughout Europe that also are competitors that we will be targeting.

So I don't think it's any one specific area. I think if we want to be successful in growing, particularly on the continent, we can't leave any stone unturned, and we'll be trying to pull volume from any number of those areas. And in terms of focus, I think over time as we get a little bit clearer in our plans, I think we'll get a bit more specific. But right now at this early stage, I'd rather not start pinpointing exactly where we're headed.

A - Joon Huh {BIO 20088238 <GO>}

Next question, please.

Operator

Thank you. Your next question will be from the line of Sanjay Sakhrani of KBW. Sir, your line is now open.

Q - Sanjay Sakhrani {BIO 7390132 <GO>}

Thanks. Maybe staying on Europe, can we just talk about how you guys are plotting out additional synergies from Visa Europe and maybe where we are on pricing and expense initiatives? Thanks.

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

We're largely through that Phase 1. When I say largely, 90%-plus through on any kind of general expense rationalization. In terms of the expense side, the next big step is just technology migration, and we're starting with the clearing and settlement processes. And beginning this quarter, maybe as soon as a couple weeks from now, we'll begin – we feel like we've gone through the thorough testing that we need to do internally, and we'll begin that migration.

And then, over time, as we get into the latter half of the year, start turning towards the migration of the authorization process and being able to then decommission some of the systems that Europe has used. Then I think that will help us, number one, reduce costs. And number two, it puts everybody around the world on the same Visa platform. And number three, the VisaNet platform just simply has more capabilities than the current authorization, clearing, and settlement system that's used in Europe today.

In terms of the revenue side, I can't remember whether I or Vasant commented on it or both of us, that we're three-quarters-plus, 80%, coming on 85% of the way through the contract renegotiations where we're moving to much more commercial terms, moving to incentives versus a rebate structure. And I think it's our expectation that we'll get through almost all of this. There might be a few laggards, but get through all of this by the end of this second quarter.

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

In terms of pricing, I think we told you earlier that there is pricing. But this year, the pricing goes into effect in the second half, and then we'll evaluate further pricing actions in the future.

Q - Sanjay Sakhrani {BIO 7390132 <GO>}

Thank you.

A - Joon Huh {BIO 20088238 <GO>}

Next question, please.

Operator

Thank you. Next question will be from the line of Ramsey El-Assal of Jefferies and Company. Sir, your line is now open.

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

Hi, thanks for taking my question. Total processed transaction growth was really healthy this quarter despite India demonetization last year. Can you give us your view on whether the progress made in India in terms of just the general electronification of payments is a permanent inflection point in that market, or do you see the market reverting to cash usage over time? There seems to be some media reports sending some conflicting signals there.

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

Thanks, Ramsey. Look, if I was to use a baseball analogy, we're still in the first or maybe the beginning of the second inning in India and there's just a long way to go. I've read some of the same reports, but I think we have hit an inflection point. We've seen a huge increase in acceptance points and volume over the course of the last, I guess now, 14 months. The government is very bullishly behind this. And while we're through the demonetization period and there's a little bit more of the cash back in circulation, I think that the government is very desirous of having the efficiencies of more electronic digital transactions as well as ideally getting past the point where they get rid of the gray economy in India and have more transparency from a tax perspective.

So my view, Ramsey, and obviously I know what I know, which isn't everything, and I think it is an inflection point. But while I say it's an inflection point, sometimes it's just that we're well into the maturation curve of this inflection point there. There's a long, long way to go. Three million merchants and the type of volume that we're at, as much as the growth rates are very attractive, is very small compared to where India will ultimately be.

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

Yeah, and just in terms of metrics that would point to your question about is this permanent, yes, there's a lot more cash in the economy because cash is back to normal. But as Al said, the number of acceptance points has doubled, and people are not pulling back. The government or the banks or all of us are still pressing hard on building acceptance. There are more people using cards. That's a measurable metric. And then there's more people using cards with a higher frequency, and that's a measurable metric. And the real test will be once we fully lap the demonetization, what is still the growth rate, and we'll tell you more next quarter.

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

Thank you.

A - Joon Huh {BIO 20088238 <GO>}

Next question, please.

Operator

Thank you. Next question will be from the line off Tom McCrohan of Mizuho. Sir, your line is now open.

Q - Thomas McCrohan {BIO 5827846 <GO>}

Yes, actually also had a question on India and the terminalization of that market. Al, can you give us a little sense of how much of the tax-related savings might go into helping terminalize that market?

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

Thanks, Tom. I don't know that – first of all, money has become fungible, but we're already investing fairly heavily in India. It's one of the markets – as I look around the world, it's one of our largest markets in terms of deployment of people, and I'm talking about people in the market. I'm not counting the 950 people we have at a technology center in Bangalore, and we were planning to grow our India presence in our plan before tax reform.

Look, we've turned back to all of our regional leaders, and Vasant and I have been asking people to tell us where they potentially could put money to work in a very smart way that's going to drive growth against the type of areas that we're already investing in. And in India, certainly one of the main areas of growth is building out acceptance, which might in some cases be physical terminals. In many cases, it will be continued use of rolling out QR technology and mVisa apps for consumers. So I think it's safe to assume that India is going to continue to be an area that we're going to look to invest in. and it's highly possible, but decision not made for sure that as a result of tax reform, we might put a bit more money into that market.

A - Joon Huh {BIO 20088238 <GO>}

Next question, please.

Operator

Thank you. Next question will be from the line of Chris Brendler of Buckingham. Sir, your line is now open.

Q - Chris Brendler {BIO 4682531 <GO>}

Hi, thanks for...

A - Joon Huh {BIO 20088238 <GO>}

Hey, Chris, we can't hear you. Can you speak up?

Q - Chris Brendler {BIO 4682531 <GO>}

Yes.

A - Joon Huh {BIO 20088238 <GO>}

Athena, I think we have a bad connection. Can we move to the next question?

Operator

Sure. Next question will be from the line of James Faucette of Morgan Stanley. Sir, your line is now open.

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

Great, thank you, just a couple of questions. First, I wanted to dig in really quickly, Vasant. If you can just talk about cross-border and how you're thinking about that getting to your expectations, especially since that seemed to decelerate maybe a little bit, at least if I'm getting the arithmetic right?

And then more broadly for both Vasant and Al, I think it was mentioned at the analyst meeting a couple of quarters back that you thought that there could be acceleration in Visa's business over the medium term, in part driven by increasing B2B opportunities. I'm wondering, looking out at that medium to long run, where we should be looking for those B2B opportunities to emerge. And what are some of the things that we should be tracking, I guess similar to the way we're trying to track acceptance in places like India, et cetera? What kinds of things should we be looking at in B2B to look for that potential acceleration? Thanks.

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

So on cross-border, just a couple of things to point out, there is, in fact, an improvement in the rate in January, and we think that will sustain based on everything we're seeing. One item that is affecting our reported numbers is this shift in Europe. Included in our cross-border number, as it is for others too, is intra-European cross-border volume. That is cross-border business within the EU. That's different than typical cross-border volume, but does get included in the cross-border volume. And you do have people moving, acquiring within Europe. And so when a fairly large account decides to acquire in the UK from a non-UK location, it's a sizable move in the reported numbers with modest revenue impacts. So if you add that back, the real underwriting growth rate was quite a bit higher than the reported growth rate.

In terms of trends that help that, as we said before, one of the best things that can happen to our cross-border business, in some respects, is a weaker dollar. We have a large U.S. acquirer business. The good news is we did see the growth rate in that business step up, but it was from very low levels. So our U.S. acquirer business, which is a very attractive business, is growing faster than it was and will most likely continue to grow faster, but is still growing less than the overall growth rate of the cross-border business. So there's one variable that could accelerate cross-border growth further would be the U.S. acquirer business growing faster and going back to double-digit levels like it has been in the past.

Beyond that, we'll have to watch what happens as European currencies strengthen. Clearly, it will help the acquiring business in Europe as it becomes more attractive for people – or rather, the issuing business coming out of Europe as it becomes more attractive for Europeans to travel out. So those are a couple of trends that are worth watching.

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

And, James, on the question about B2B, it really is a large opportunity. We are focused on it. We have a senior person and a keen focus on B2B. We think that through the use of Visa Direct, we can meet the needs of a lot of the small and medium-sized merchants using things like single-use virtual cards in larger verticals like healthcare and travel.

That said, you raise a good question around how we can give you guys a bit more insight into our progress. And let me take that away and maybe next quarter or at some point later this year, we'll try to give a little bit more insight in terms of things to watch there and how you can evaluate the progress we're making along the way.

A - Joon Huh {BIO 20088238 <GO>}

Next question, please.

Operator

Thank you. Your next question will be from the line of Jason Kupferberg of Bank of America. Sir, your line is now open.

Q - Jason Kupferberg {BIO 6867809 <GO>}

Hey, great. Thanks, guys. So I think you mentioned, Al, that during holiday season in the U.S, e-comm was about 30% of volume. Can you give us some broader e-comm metrics globally, what percentage of global volume, how fast is it growing?

And then I just was curious to get your quick take on the contactless initiatives in the U.S. What's the issuer response so far because it sounds like that would create some new expense for them? So I just wanted to get your perspective there. Thanks.

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

On the first question, Jason, I don't think we're prepared to start giving a breakdown on a country-by-country basis on e-commerce versus card-present type of growth. I think in developed countries, the trends that I talked about in the U.S. are similar in some of the developed countries. Obviously, in less developed countries, the mix and the dynamics between the two are different.

In terms of contactless, look, I think in the United States, again, the plumbing is in place to go. We think by the end of the year, 50% of the terminals in the U.S. will be contactless-enabled. Virtually every terminal being shipped now is contactless-enabled. And I think the U.S. issuers are getting excited about the prospects of the customer experience associated with contactless. And I would expect that you're not going to see a massive off-cycle replacement of cards that are NFC-enabled. But I think that you will start to see issuers as they go through their normal card renewal cycles and as they replace cards that are lost or stolen, et cetera, that more of those will be replaced with cards that are NFC-enabled.

So I think this is a multiyear journey. But again, there will be an inflection point at some point where it will really take off as we reach a certain level of scale. And clearly, we're not there yet, but I think we're poised to begin the journey.

A - Joon Huh {BIO 20088238 <GO>}

Athena, I think we have time for one last question.

Operator

Thank you. Our last question is from Bryan Keane of Deutsche Bank. Sir, your line is now open.

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

Hi, guys. I just want to ask about the operating margins. They were down I think 1 point year over year, and it looks about 1 point short where the Street was estimating. So I just want to think about personnel and G&A costs, which are up a lot. Does that continue throughout the year? And how much did you take advantage of just lower tax reform in the quarter to maybe crank up the expenses, which caused a little bit lower margin?

And then just to follow up on Visa Europe, the technology migration going on, will that have a positive benefit to margins in fiscal year 2019 as a result of that? I'm just trying to figure out about how much. Thanks.

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

On the expense side, you might recall when we talked to you last quarter about outlook, we have indicated that you should expect expense growth to be higher in the first half than the second half. A lot of it has to do with year-over-year comparisons. Personnel expenses were unusually low in the first quarter of last year for a variety of reasons. I won't go into all of them. Some of it had to do with the consultation process that was underway in Europe. Some had to do with the fact we had also done the global restructuring coming into the quarter. So personnel expenses were off to a fairly slow start. And if you looked at our personnel expenses last year, they climbed through the year. So this rate of growth in personnel expenses you should not see continuing beyond the first half. So there are year-over-year comparisons.

On the G&A side, as I said, there were some non-recurring items and some shifts in expenses that make that number higher than it normally would have been. So we did have a number of expenses in the quarter that were of a non-recurring or timing variety. But our original outlook for expenses remains unchanged versus what we told you. We have deliberately chosen to reinvest an additional 2 points in expenses as a result of tax reform. I wouldn't say a lot of that was in this quarter. It was more what we expected based on comparisons plus some of these non-recurring and timing-related things.

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

And on the second question, Bryan, I think we have to see how – we haven't even begun the migration. As I said, we begin this quarter. I think we're going to have to see how long it takes. We're going to be measured and deliberate and careful about it. We will get some benefit from it financially once we're all the way there. But I think in terms of timing, it's a little bit too early to say. And I think in terms of dimensioning it, I'm not actually sure we had dimensioned it. It's all part of having this transaction continue to be accretive at a level above what we thought it would be when we made the acquisition in the first place.

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

Okay, that's helpful. Thanks, guys.

A - Joon Huh {BIO 20088238 <GO>}

And with that, we'd like to thank you all for joining us today. Have a great day.

Operator

Thank you, and that concludes today's conference. Thank you for joining, everyone. You may now disconnect.