Visa Inc. (V)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

Price ($) (5/15/20): 183.49
52WK H-L ($) : 214 - 134
Market Cap (mil): 415,605
Shares Out (mil): 2,265.0
Float (mil): 1,704.2
Dividend ($) : 0.84
Yield (%): 0.5
Rating: Outperform
Suitability: Average Risk
Price Target ($) : 190
L-Term Rev. Gr Rate Est: 12%
L-Term EPS Gr Rate Est: 17%
Debt/Cap: 39.9%
ROE: 30.4%
Outperform Average Risk FY Sep 2019A 2020E 2021E
Q1 1.30A 1.46A 1.36E
Q2 1.28A 1.39A 1.42E
Q3 1.37A 1.04E 1.46E
Q4 1.46A 1.15E 1.50E
Total 5.40A 5.04E 5.74E
FY P/E 34.0x 36.4x 32.0x
EPS (Cal) 5.61A 4.93E 5.97E
P/E (Cal) 32.7x 37.2x 30.7x

Company Description
Visa is the largest global card transaction processing firm, with leading positions across most worldwide geographies. As a percentage of the ~$8.6 trillion in F2019 payments volume, ~45% was generated in the US and ~55% internationally, and roughly ~55% from credit and ~45% from debit. The company has generated strong earnings growth in recent years driven by solid revenue growth (growth in spending, shift toward spending on cards, pricing increases) and expense leverage.

Revenue Profile
Visa derives revenue from several different sources, including:
- Service Fees (~35% of gross revenue) and Data Processing Fees (~36%) -- Revenue from interfacing with merchant terminal, acquiring bank and card issuer; includes authorization and settlement/clearing processing.
- International Transaction Fees (~24%) -- Driven by cross-border spending; higher processing and currency conversion fees (vs. domestic transactions). A portion of these fees are related to daily fx volatility.
- Other revenue (~5%) -- Includes revenue from optional service or product enhancements.

Volume & Support Incentives (contra-revenue; ~23% of gross) -- Cash and incentives paid to banks for generating certain volume/transaction requirements on Visa cards.

Economics
Average 20-30bps (gross) of purchase volume.
- Service fees -- roughly 10-11bps of yield on purchase volume (~12-13bps core and ~0-2bps Visa Europe)
- Data processing fees -- roughly $0.07 per transaction processed (~$0.06-0.08 core, ~$0.03-0.04 Visa Europe)
- International transaction fees -- generally paid 100bps+ of volume.

Metrics
- Transaction type -- Purchase ~75% of volume (full economics); Cash ~25% of volume (minimal economics).
- Card type -- Credit ~53% of purchase volume; Debit ~47%.
- Geography -- US ~46% of purchase volume; Rest of World ~54%.

Competition
- Card Networks -- MasterCard, American Express, Discover (including Diner's Club), JCB, regional debit networks.
- Market Share (dollar volume) -- Visa ~60% of worldwide volumes; MasterCard ~27%; Other ~13%.

Market Growth
- More mature markets (US, Canada, Australia) -- Expect mid- to high-single-digit long-term growth, with credit outpacing debit.
- Emerging markets (Latin America, Eastern Europe, Africa, Asia-Pacific, Middle East) -- Expect double-digit long-term growth, with credit slightly outpacing debit.
Quick Summary

- FQ2 net revenue was above our/consensus’ recently lowered expectations; EPS beat mostly on costs.
  - Adjusted EPS $1.39 (+9% yoy) was above our/consensus $1.34 estimate. Variance to our estimate primarily due to gross revenue (+$0.02), margins (+$0.04), and other (-$0.01).
  - Net revenue +7% yoy organic constant-fx (called out ~0.5% acquisition impact) to $5.85 billion (decelerating from +10% yoy in FQ1), and was above consensus $5.72 billion estimate (we were $5.78 billion).
  - Fx was a ~1% headwind (we modeled ~1.1% headwind).
  - Adjusted operating margins were 67.3% (up ~100bps yoy; we modeled 65.3%).
  - FCF/share of $0.56 (below EPS of $1.39) which is ~42% conversion (last three year conversion has been ~61% in FQ2).

- April trends (though April 28) provided on FQ2 earnings:
  - US Payments: US volume was -19% (+6% in FQ2); Credit was -31% (+4% in FQ2; credit volumes have declined more than 25% every week in April); Debit was -6% (+8% in FQ2; debit volumes were positive growth in H2-April)
  - Processed Transactions: -25% (+7% in FQ2); noted this was slightly better than levels in the last week of March
  - Cross-border Volume: -43% (-2% in FQ2); -52% excluding intra-Europe volumes (-5% in FQ2); card present/card-non present travel volumes -80% with eComm decelerating but continuing positive growth
  - Management withdrew F2020 guidance on the call…but gave some color on rebates/incentives, expenses, acquisitions
    - Rebates/Incentives (remain intact): 22.5-23.5% of gross revenue
    - Expenses for FH2-20: Flat yoy reported (including acquisitions). Excluding acquisitions, expenses are expected to be down low-single-digits yoy
    - Non-operating expenses for FH2-20: ~$250 million in FH2-20 (ex gains and losses) vs. $148 million in FH1-20 due partly to new debt.
  - Our new $190 price target reflects ~30.5X NTM P/E of prospective EPS a year from now ending 6/30/22 of $6.20. A ~30.5X reflects an ~55% premium to the S&P’s NTM P/E, near the 2017-2019 average of ~56% premium. Late in an expansion (or early in a recession), we think investors like the relative long-term resilience/secular growth of V. Our ~30.5X multiple is below the recent peak multiple of ~34X NTM, given the environment is less certain.
Visa Inc.
May 18, 2020

Investment Thesis

Significant barriers to entry. Visa is the world's largest payment processing company, providing processing services to 30+ million merchants around the globe. Roughly ~3.5 billion Visa-branded cards are currently in circulation, with total annual purchase volume of ~$8.6 trillion. Given the company's well-established brand and extensive merchant-acceptance network, we believe Visa's business model would be difficult for competitors to replicate.

Secular shift toward card payments. Over the past several years, card payments have gained market share, at the expense of cash and checks (we expect this to continue). US market share for card payments has increased from 32% in 2001 to over 50% in 2014, and continues to grow. Concurrently, the cash/check market share has decreased significantly.

International markets provide both diversification and growth opportunities. Approximately 45% of Visa's total revenue is generated in the United States – we expect this market to grow mid- to high-single-digits over the next several years, due largely by the continued shift from cash/check to plastic. The remaining 55% of revenue is driven by international regions, including Asia-Pacific, Canada, Latin America, Africa, Europe and the Middle East – we believe these markets in aggregate can generate double-digit growth over the next several years, driven by consumer spending and the shift to cards. Given the penetration opportunities for these markets (and the relative immaturity versus the US), we believe Visa's international exposure provides the company with opportunities to further diversify its revenue base.

Leverage opportunities create a more resilient business model. Visa's processing costs are highly fixed, in our view, creating very high incremental margins (85-90%+). Importantly, appropriately managing the two largest variable expense items, personnel and advertising/marketing/promotions, could yield solid operating profit growth, despite potentially slowing purchase volumes.

Long-term international travel growth provides benefits. Cross-border transaction fees are a large component of Visa's revenue stream (~25% of total gross revenue) and are driven by international travel. International growth slowed (and even declined) during 2008/2009, but accelerated back to 10%+ growth in recent years. We expect solid long-term growth in international travel given globalization.

Risks & Caveats

Slower consumer spending. Uncertainty in the economy could lead to slower spending by consumers and subsequently lower credit and debit transactions/volumes for Visa. The secular shift toward card payments (away from cash/check) should mitigate some impact of reduced consumer spending. In recent quarters, growth has accelerated as the economy has recovered.

Litigation risk. The company has a number of outstanding lawsuits (anti-trust, unfair competition, etc.) that could lead to unfavorable outcomes and potential payouts for damages and/or settlements. While Visa has a retrospective responsibility plan to cover certain potential obligations, the burdens from any new litigation will have to be borne by the company.

Regulatory risk. Interchange fees are an important component of the four-party payments system Visa facilitates. Recently, interchange fees have come under increasing scrutiny from regulatory authorities in a number of different geographies. If Visa is no longer allowed to set interchange rates, financial institutions may be less willing to issue new cards and/or may seek to subsidize their credit card businesses, either through fees to cardholders or reduced pricing from the networks.

Foreign exchange risk. A portion of the company's revenue is denominated in currencies other than the US dollar. Significant depreciation of the euro, the Brazilian real and several other global currencies could pose a material headwind to growth and profitability.

Financial institution consolidation. The number of financial institutions (the company's primary clients) has been decreasing by an average 2-3% annually over the past several years. While many institutions issue both MasterCard and Visa-branded cards, certain institutions may have an exclusive or nearly exclusive relationship with competitors for certain products and services. If the clients of Visa were acquired by financial institutions exclusively using other network providers, the company may be at risk to lose client relationships and the associated revenue.

Reduced global travel. A significant portion of the company's revenues and profits are derived from fees on transactions taking place outside of the country where the card was issued. If travel slows globally, a portion of the company's higher-margin revenue may be at risk.

Alternative payments systems. A number of alternative payments systems have gained in popularity recently, particularly in the area of internet-based payments (PayPal, Bill-Me-Later, etc.). Visa may lose some share of the paperless payments market if some of these alternative systems continue to gain acceptance.

Supplemental Information
### Quarterly Trends Review (yoy)

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<th>FQ2-19</th>
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<td>Service Fee Gth (~36% of revs)</td>
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<td>Volume growth (const-fx prior qtr)</td>
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<td>Fx Impact (prior qtr)</td>
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<td>Data Processing Gth (~34% of gross)</td>
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<td>International Gth (~25% of gross)</td>
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<td>Other Revenue Gth (~4% of gross)</td>
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<td>49%</td>
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<td>22%</td>
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<td>Incentives Gth (contra rev)</td>
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<td>% of Gross Revenue</td>
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<td><strong>Geography</strong></td>
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<td>US revs (~45%)</td>
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<td>Volume (one-qtr lag)</td>
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<td>Yield</td>
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<td>ROW revs (~55%)</td>
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Source: Company Reports, Baird Estimates
Appendix - Important Disclosures and Analyst Certification

Covered Companies Mentioned
All stock prices below are the 5/15/2020 closing price.

MasterCard Incorporated (MA - $278.94 - Outperform)
(See recent research reports for more information)

Visa Inc.
May 18, 2020

Rating and Price Target History for: Visa Inc. (V) as of 05-15-2020

Rating and Price Target History for: MasterCard Incorporated (MA) as of 05-15-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of V and MA.

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