LOWELL, BLAKE & ASSOCIATES
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To: LBA Clients
From: LBA Research Department
Date: November 21, 2017
Subject: **Visa, Inc. (V)**

Common Shares Out: 2.1 billion

Curr. Price	12 Mos. Range	5-year Range	Div.	Yield	EPS* 2017	EPS* 2018E	EPS* 2019E	P/E 2018E	P/E 2019E	Debt Ratio
$111	$112-75	$112-35	$0.78	0.7%	$2.84	$3.60	$4.09	31	27	33%

***Fiscal year ends September 30th**

Sector & Industry: Information Technology; Business Services

Company Description

Visa's roots go back to the first general purpose credit card launched in 1958 by the Bank of America. After licensing the card to banks around the world, the business evolved into a global network that was owned by an alliance of participating banks. In 1976, the network was rebranded as Visa and in 2007 the business went public through an IPO. Currently based in Foster City, California, Visa is the largest payment network provider in the world, processing approximately 60% of global electronic payment volume. The company operates global transaction processing networks for use with bank credit cards, debit cards and other digital payment systems, to facilitate transactions between buyers, merchants, and their banks in over 200 countries. Visa earns revenue primarily from card-issuing banks based on purchase volumes and transactions as well as other international and data processing fees.

In fiscal 2017, the Visa network processed about 94 billion transactions, a 13% increase over 2016 while total dollar volume continued to grow at a double-digit rate. Total net revenues came in at $18.4 billion. Service revenues (36% of gross sales) rose 18%, to $8.0 billion, Data Processing (34%) rose 24%, to $7.8B, International (25%) rose 36%, to $6.3 billion, and Other (5%), which rose 2% to $841 million. Client Incentives, a contra-revenue category, designed to increase payment volumes with existing customers, totaled $4.5 billion and made up 20% of gross sales.

Performance Update

Visa recently reported on the company's fourth quarter results, ended September 30, 2017, and turned in another positive operating performance. Figures were elevated for several reasons including the acquisition of Visa Europe (Europe was not part of the 2008 IPO). Visa paid a total of €17.5 billion ($19.6 billion), financed 70% by debt and 30% by stock. Another €1.0 billion ($1.1 billion) is due to Visa Europe's former owners in June 2019. Revenues were also boosted in FY2017 by the new Costco account, the switch by USAA from MasterCard to Visa and the demonetization in India that doubled transaction volumes. Activity on the Visa network rose briskly with the average payment volume rising 10% from Q4 of the prior year and with Visa processing 29.2 billion transactions, up 13%.

A look at the income statement shows another quarter of double-digit growth. Net income was $2.1 billion in the fourth quarter (+11%) and earnings per share were $0.90 (+14%) – boosted by a 3% buyback of shares. Net operating revenues rose 14% to $4.9 billion from the previous fourth quarter with service revenues up 20% to $2.1 billion, data processing revenues up 16% to $2.1 billion, international transaction revenues up 20% to $1.8 billion, and other revenues up 3% to $226 million. Client incentives, the contra revenues item, were $1.3 billion and 21.7% of sales. Meanwhile operating expenses, excluding a special item from the prior year for severance costs, increased 8%. Operating profit improved 17%, as the margin improved to 66.2%, from 64.2%. After adjusting for interest expenses and taxes at a 31% tax rate, diluted earnings per share came out 14% higher than the previous year at $0.90 a share.

The quarterly dividend was raised 18% to $0.195 per share on November 16th, representing a mere 22% of our fiscal 2018 earnings estimate. We expect similar raises going forward. The balance sheet is sound despite taking on $17 billion of debt from the acquisition of Visa Europe. Debt currently represents 33% of the firm's capitalization. At the end of December, cash and investments of $14.5 billion covered total current liabilities of $9.9 billion, and the current ratio stood at a strong 1.9:1.

Outlook & Recommendation

Visa benefits from strong secular trends in the global economy. There is an ongoing shift from cash and check point-of-sale payments to electronic payments. Visa has grown its share of point-of-sale payments over the last four years from 31% to 36% with volume growing at 150% over the same period. Taking market share from cash is a good business. The global value of cash and check transactions has reached $17 trillion and is still growing despite the ongoing shift toward electronic payments.

Visa also benefits from the shift toward mobile and e-commerce transactions. While Visa captures about 15% of total spending in the brick-and-mortar retail space, it captures 43% of spending in the e-commerce space. Thus, Visa's growth is amplified by the shift toward online spending. Currently $2 trillion dollars of global sales occur online and this space is growing five times faster than brick-and-mortar.

Visa's business strategy is to maintain leadership in the design of the global network, while integrating new players into the network. The payments industry is entering an inflection point with accelerating numbers of people and devices accessing the internet around the world, presenting business opportunities as well as risks. As a result, Visa faces a steady stream of upstarts like PayPal looking to compete for profits. Visa's response to PayPal has been to collaborate with it, where PayPal promotes Visa while piggybacking on Visa's global reach. The government sector poses another business risk where countries tend to put regulations on the payments industry to manage fair competition and other local priorities. Visa's response has been to treat governments as partners, seeking to work within government guidelines and to create solutions for governmental goals such as pushing payments out to rural residents using Mobile Visa.

Looking forward, we have confidence that Visa can continue to perform well within the broader payments industry. We see long-term sales and earnings growth averaging 8% and 12%, respectively, driven primarily by cash-to-card conversion. With the stock trading at its traditional premium valuation (27 times our 2018 earnings estimate), we continue to consider Visa a core holding in client accounts.

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