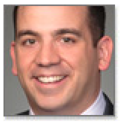
Visa Inc Class A V |

Visa is winning the payment wars.



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Morningstar's Editorial Policies

Analyst Note 11/02/2017

We don't intend to make significant revisions to our tax reform assumptions following the House Committee on Ways and Means' release of the Tax Cuts and Jobs Act. This is the first document with actual details of how tax reform may work, but it will be adjusted as political constituents digest it and attendant political realities, such as the slim Republican majority in the Senate, are taken into account. We continue to believe that tax reform during the Trump administration is more likely than not to occur and that the tax reform assumptions that we've incorporated into our valuations are a reasonable approximation of the potential outcome. In the realm of corporate tax reform, the bill touched on many of the areas that we previously opined upon, such as the corporate tax rate, depreciation, interest expense, treatment of foreign earnings, and tax credits. Therefore, we don't plan to make any changes to our economic moat ratings or fair value estimates because of today's release and will continue to monitor the situation.

The headline corporate tax rate proposed in the Tax Cuts and Jobs Act is 20%, lower than our current 25% assumption. However, many revenue-related parts of the tax reform bill have been scaled back from initial proposals. For example, the latest bill allows the partial deduction of mortgage interest and property taxes. These alterations mean the current bill would likely raise federal debt levels more than many had initially projected. To attain the votes of spending hawks, the aggressiveness of the bill may have to be scaled back. The overall corporate tax rate remains a key lever for negotiation, as effective tax rates truly determine the competitiveness of the U.S. relative to other countries. Industry groups will certainly push to keep their tax credits, and to the extent these credits lower effective tax rates, a modestly higher headline rate can keep the U.S. competitive with other countries.

Investment Thesis 12/30/2016

Visa dominates the global market for electronic payments, accounting for about half of all credit card transactions and an even higher percentage of debit card transactions, according to the Nilson Report. As consumer spending around the world grows and digital methods continue to take share from cash, this wide-moat company should continue to flourish for years to come as an effective toll booth on global spending.

Visa has been coordinating the interaction of banks, consumers, and merchants for decades. Its effective network consists of 16,800 financial institutions, 44 million merchants, and billions of cards issued to customers around the world. This creates a formidable barrier to entry. While many potential competitors have close connections to consumers, the global financial institutions that rely on Visa are much harder to penetrate. Indeed, firms like Apple and Alphabet have chosen to use existing networks to process payments in the digital environment, and even successful competitors like PayPal are choosing to partner with--rather than attempt to disrupt--

Morningstar's Take V

Analyst

Price 12-15-2017	**Fair Value Estimate**	**Uncertainty**
113.82 USD	108 USD	Medium
Consider Buy	**Consider Sell**	**Economic Moat**
75.6 USD	145.8 USD	Wide

Stewardship Rating
Standard

Bulls Say

- Visa is king of the hill in the digital payment market and will not be easily toppled.
- The ability to deal with hundreds of legal and regulatory frameworks around the world is a significant barrier to entry.
- Visa has an established network and brand and has only to adopt new technologies for its own purposes in order to fend off competition.

Bears Say

- The global financial system is becoming increasingly regulated, and the biggest players will be the first victims.
- Visa's already large market share, and its relative dependence on U.S. spending and debit cards, may place it at a growth disadvantage.
- The increasing use of mobile technologies will usher in a new payment paradigm at some point.

Competitors V

More...

Name	Price	% Chg	TTM Sales $ mil
Visa Inc Class A	**$113.82**	**0.80**	**18,358**
American Express Co	$98.52	1.41	32,654
Capital One Financial Corp	$96.31	2.39	26,790
PayPal Holdings Inc	$75.65	1.87	12,331
Synchrony Financial	$37.19	0.54	12,070
Mastercard Inc A	$153.40	0.97	11,941

incumbents. Just as Visa set the standard for card payments in the past, it is determining the course of future digital payments.

Of course, the company's position is not completely unassailable. Its market power regularly grabs the attentions of regulators. Visa's ability to set high interchange fees as incentives for issuing banks is eroding around the world. In Europe, regulators are attempting to allow upstarts to access existing bank accounts, and the U.S. is set to issue bank charters to technology firms. Merchants are also clamoring for lower-cost payments. However, we see few rivals able to match the scope of the global Visa network, its brand strength, and its technology and security offerings.

In fact, Visa's competitive position could conceivably be strengthened by the proliferation of digital payment options as technology standards expands in importance and the ability to analyze large amounts of transaction data grows. If competitors fail to take share during the transition from cards to mobile payments, Visa could be entrenched for decades to come.

Economic Moat 12/30/2016

The payment industry has historically benefited from several sources of competitive advantage, the most powerful being network effects. For a payment method to be useful, it must usually be accepted by numerous merchants. Conversely, merchants have little incentive to accept a payment method used by just a handful of consumers. This chicken-and-egg problem has meant that only a handful of networks around the world--including Visa and MasterCard--dominate processing volume. Importantly, Visa and MasterCard are not actually networks of cardholders and merchants. Instead, they are networks of banks; their members include thousands of financial institutions around the world. This creates a regulatory hurdle for competitors and an intangible asset contributing to competitive advantage. Another intangible asset is the trusted brands associated with payment networks. Visa, MasterCard, and their partners have spent billions of dollars over decades to create their brands. Customers know that Visa-branded cards are likely to be accepted worldwide and that their financial information is fairly secure. The dominant market positions of the payment networks have resulted in economies of scale. With billions of transactions representing trillions of dollars processed every year, Visa and MasterCard possess unmatched scale--yet another barrier to entry for potential competitors.

Visa therefore possesses a wide moat. It is the largest processor of transactions in the world, with 58% market share, according to the Nilson Report. The brand is accepted by approximately 44 million merchants worldwide, with 3.1 billion cards in circulation. The network processed $8.2 trillion in volume in the 12 months ended Sept. 30. Perhaps most important, 16,800 financial institutions worldwide make up the Visa network. The brand itself is well recognized. According to Interbrand, Visa is the number 61 brand in the world, just ahead of Cartier and Starbucks.

Valuation 06/07/2017

We are raising our fair value estimate to $108 from $101 per share as we account for the time value of money since our last update and lower long-term U.S. tax rate assumptions. As a wide-moat firm, we believe Visa will be able to pass on some of the economic benefits from a lower tax rate to shareholders. Our fair value represents 28 times our fiscal 2018 earnings per share estimate. We expect the firm to benefit from growing consumer spending and a rapid cash-to-electronic transition on a global scale over the next five years, offset by a slight market share decline as alternative payment options including merchant-centered/private label transactions grow in importance, and upstarts provide viable choices in emerging markets. We believe revenue growth will average 10% annually over our five-year forecast period, with operating margin--as we calculate--growing from 52% in fiscal 2017 to 57% in 2021. We think rebates and incentives will consume 19% of gross revenue over this period, up slightly from the last five years as Visa's customers demand more from the firm as their own profits are pressured. We expect capital expenditures to double cumulatively over the next five years as the company invests in changing technology.

Over the longer term, we think growth in earnings before interest will average 7% annually between 2021 and 2036.

Risk 12/30/2016

The largest risk to Visa, in our view, is related to regulation and litigation. As an extremely profitable participant in an oligopoly, Visa is often the target of lawyers and politicians. For example, the interchange payments that provide incentives for banks to issue Visa cards have been severely limited in markets including the U.S., Europe, and Australia. Several countries have attempted to provide low-cost processing alternatives. Merchants have also taken issue with the company's fee-setting practices.

Management 06/07/2017

We view Visa's stewardship as Standard. Former CEO Charles Scharf took the helm in late 2012 after spending time at JPMorgan Chase, where he was head of retail financial services, as well as Bank One, Citigroup, and Salomon Smith Barney. We liked the steps Scharf took to ward off competition, playing hardball with PayPal and Apple Pay in order to keep the Visa brand at the top of consumers' minds. However, he resigned unexpectedly in 2016 to return to the East Coast. He was replaced in December 2016 by Alfred Kelly, a former American Express executive. The transition is happening at perhaps an inopportune time for Visa: The firm has just begun to integrate the operations of Visa Europe, payment technology is changing rapidly for the first time in decades, and the network's market power is resulting in sizable lawsuits and the continued attention of global governments. All that said, the company's wide economic moat should grant Kelly plenty of latitude to deal with these issues.

We like Visa's efforts to return capital to shareholders. The company effectively returned all of its net income to shareholders via buybacks and dividends over the past three years. However, we think a higher dividend payout would increase the firm's appeal to shareholders. In fiscal 2016, Visa used $7 billion of cash for repurchases versus only $1.4 billion in dividends.

At the same time, the company has not been highly acquisitive. We believe the company's acquisition of Visa Europe will strengthen its economic moat and growth prospects, and we view the high-priced deal as a strategic necessity. We also think small acquisitions in the technology space are likely.

Overview

Profile:

Visa manages payment brands and an "open loop" global payment network, which allows it to provide authorization, clearing, and settlement of electronic payment transactions. The firm generates revenue by charging fees to its customers (issuers and acquirers) based on the dollar volume of card activity and the number of transactions processed through the network.