MasterCard Inc A MA

The global decline of cash is a boon for MasterCard.

by
Jim Sinegal
Senior Equity Analyst

Authors can be reached at Analyst Feedback

Morningstar's Editorial Policies

Investment Thesis 01/29/2016

In our view, the MasterCard network functions as a tollbooth on financial transactions, generating a small amount of revenue from every transaction that runs through its network and every dollar of payments made using the MasterCard brand. We expect that MasterCard will eventually process a much larger share of total payment transactions, resulting in healthy top-line growth for years to come. MasterCard's global presence strengthens this tailwind even further--well over half of revenue is generated outside the United States. It's highly likely that consumer spending will slowly rise within those economies, and we expect those consumers to move away from cash at a rapid rate. Though the strong dollar and a recovering U.S. economy may change the balance in 2016, the long-term remains favorable.

In fact, we think the transition to mobile payments, aided by "digital wallets," will only increase the volume running through MasterCard's network. The digital wallet, in our view, is a vehicle for marketing more so than payments. Numerous companies are fighting to connect merchants and consumers for this purpose, but this does not mean that all are anxious to enter the highly regulated (and smaller) market for payments. Apple, for instance, has found initial success by cooperating with networks and issuers. MasterCard itself is expanding its capabilities in data analytics.

Payment market share, due to powerful network effects and resulting "winner take all" economics, is quite concentrated. Highly profitable businesses of this type often run into regulatory limitations, and we see this as the biggest obstacle to MasterCard's success. We don't see interchange limits as a game-changer, though. Instead, we think they result in a shift of economics from issuers to merchants and continue to drive up the percentage of network revenue returned to customers in the form of rebates and incentives. However, networks now see both card issuing banks and the merchants who accept payments as customers, and their ability to offer value to both sides of the network will be a key factor in maintaining economic moats.

Economic Moat 01/29/2016

A powerful network effect is responsible for MasterCard's wide economic moat. A payment method widely accepted by merchants is attractive to cardholders, while a payment method used by many cardholders is attractive to merchants. Thus, each additional user of the MasterCard brand increases its value to others. Such a network is extremely difficult to replicate, with regulatory factors producing significant barriers to entry.

The company also benefits from other moat sources. A trusted brand is important to users of payment systems, and MasterCard has spent billions of dollars over decades on this intangible asset.

Valuation 01/29/2016

Morningstar's Take MA

Analyst

Price 02-12-2016	**Fair Value Estimate**	**Uncertainty**
84.89 USD	120 USD	Medium
Consider Buy	**Consider Sell**	**Economic Moat**
84 USD	162 USD	Wide
Stewardship Rating		
Standard		

Bulls Say

- MasterCard is poised to benefit from powerful secular trends over the next decade, as economies outside the United States grow and the use of cash declines.
- Payment data is valuable to marketing and advertising companies like Google, who can use this information to improve their own offerings to customers and merchants.
- The company will be able to grow revenue significantly without taking on much in the way of additional costs.

Bears Say

- Mobile technology provides an opportunity for new entrants to disrupt longstanding payment standards, or relegate network offerings to merely "dumb pipes" carrying transaction data.
- Legal and regulatory pressure against interchange fees and other aspects of the current value creation and transfer system is building.
- As merchants have consolidated, their bargaining power has grown. Merchants would like nothing better than the emergence of a lower-cost payment paradigm.

Competitors MA

More...

Name	Price	% Chg	TTM Sales $ mil
MasterCard Inc A	**$84.89**	**3.39**	**9,593**
American Express Co	$52.66	3.03	33,612
Capital One Financial Corp	$62.54	3.97	23,032
Visa Inc Class A	$70.42	2.85	14,063
Synchrony Financial	$25.37	3.55	12,203
PayPal Holdings Inc	$34.30	2.33	9,248

We are raising our fair value estimate for MasterCard to $120 per share from $106 based on higher long-term growth assumptions after an extensive review of global electronic payment growth prospects, in addition to the time value of money since our last update. The newly increased fair value estimate represents 29 times our fiscal 2017 earnings per share estimate. We expect revenue growth to average 9% in the next five years, with operating margin averaging 40%, as we calculate, over this time frame. We think long-term earnings growth could be similar, and forecast pretax operating income growth averaging 8% per year post-2019. We expect capital expenditures to consume just under 3% of revenue, moderately lower on an absolute basis than our forecasts of Visa's capital spending thanks to the company's smaller share of the global market.

Risk 01/29/2016

The largest risk to MasterCard, in our view, is related to regulation and litigation. As an extremely profitable participant in an oligopoly, MasterCard is often the target of lawyers and politicians. For example, the Dodd-Frank Act limited debit interchange fees in the United States in 2010, and the European Union has taken the first steps toward new regulations covering interchange and other aspects of the payment system. MasterCard also agreed to modify surcharge rules in 2012 as the result litigation with merchants in the United States. Additionally, MasterCard could be vulnerable to disruption via new technologies or innovative agreements between issuers and acquirers.

Management 01/29/2016

We rate MasterCard's stewardship as standard. Ajay Banga became CEO in 2010, and has been the architect of various programs to expand MasterCard's presence worldwide--a smart strategic move, in our view. We are especially intrigued by the company's efforts to expand its business with governments and in other areas of payments, like bills, that cards have minimally penetrated.

On the capital allocation front, MasterCard has made a few acquisitions that looked pricey at first glance but are relatively small bets for the company. We like that MasterCard has been steadily increasing its quarterly dividend, and we also look favorably on the company's share repurchase program.

Overview

Profile:

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