Visa

Information Technology
NYSE: V
Market Outperform | Buy

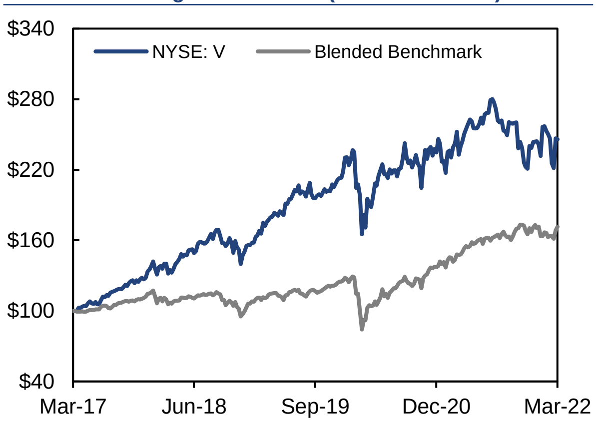
March 31, 2022
Eric Xiao, Investment Analyst

Return on Investment	
Current Share Price	$226.36
Target Price	$290.00
Dividend Yield	0.66%
Implied Return	29%
Conviction Rating	2

Market Profile	
52-Week Range	$186.67 - $252.67
Market Capitalization (US$mm)	$458,266
Net Debt (US$mm)	$4,490
Enterprise Value (US$mm)	$462,756
Beta (5-Year Monthly)	0.92

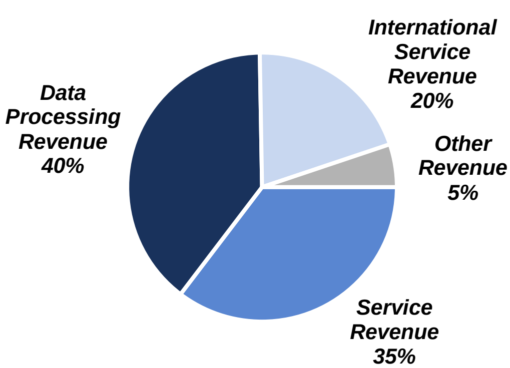
Metrics	**2022E**	**2023E**	**2024E**
Revenue (US$mm)	$28,003	$31,893	$34,372
EBITDA (US$mm)	$19,816	$22,613	$24,303
EPS (US$)	$6.73	$7.73	$8.33
EV/EBITDA	23.4x	20.5x	19.0x

Historical Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: 2021 Revenue Mix



Source: Company Filings

Business Description

Visa (NYSE: V) is the world's largest payments technology company, providing services in more than 200 countries and territories. In 2021, it processed over 164B transactions and experienced US$10.4T in payments volume across its business. V facilitates payments among consumers, businesses, financial institutions, and governments globally through its VisaNet network, which enables the authorization, clearing, and settlement of payment transactions. The Company also offers card products with varying degrees of associated benefits, platforms, and value-added services.

Segment Overview

Under V's Payment Services segment, its business is divided into four unofficial revenue sub-segments: Service Revenue, Data Processing Revenue, International Transaction Revenue, and Other Revenue, which are reported gross of client incentives. Client incentives are long-term contracts with clients, merchants, and strategic partners that provide cash and other incentives with the goal of increasing revenue through payments volume growth. These are classified as reductions in revenues.

Service Revenue: The second-largest source of V's gross revenue is Service Revenue (35%), earned for services provided to support clients' use of Visa payment services. These revenues are driven by payments volume. For example, the purchase of a smartphone will generate more service revenue than a pair of socks. As the dollar volume of a transaction rises, so does the fee, representing a natural inflation hedge for the Company.

Data Processing Revenue: Data processing revenue makes up ~39% of gross revenue, representing the fees collected for the authorization, settlement, and clearing of payments, as well as value-added and other services for its payment network. In contrast to Service Revenue, these fees depend on the number of transactions processed.

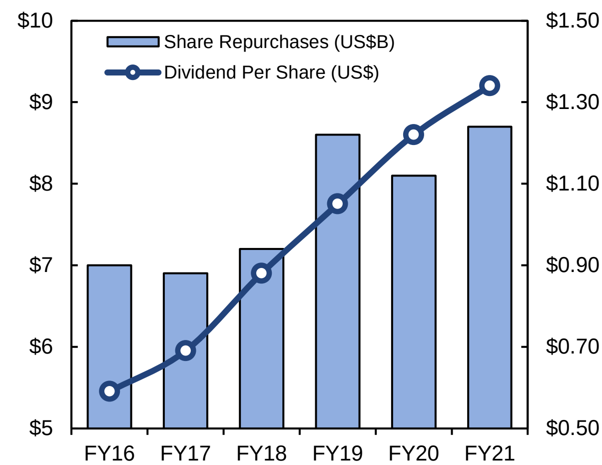
International Transaction Revenue: 20% of revenues are derived from cross-border transaction processing and currency conversion activities, driven by cross-border payments volume. Cross-border transactions occur when the country of origin of the issuer originating the transaction is different from that of the beneficiary.

Other Revenue: The remaining 5% of revenue is comprised of license fees for the use of the V brand or technology, fees for account holder services, and licensing and card benefits.

Industry Overview and Competitive Landscape

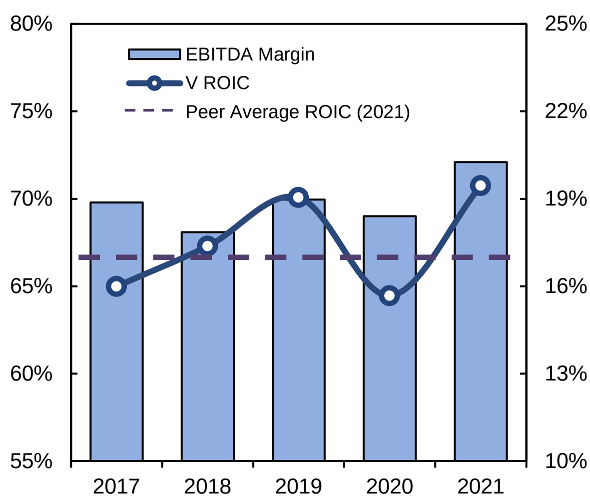
The electronic payments industry is dominated by a few players, namely V, Mastercard (NYSE: MA), American Express (NYSE: AXP), Discover Financial (NYSE: DFS), Capital One Financial (NYSE: COF), and PayPal (NASDAQ: PYPL). V and MA differ from the broader group in that they neither extend credit nor issue cards directly. Instead, they partner with financial institutions to issue cards to individuals and businesses, often in partnership with airlines, hotels, or retail brands to offer the perquisites that come with their cards. Thus, V and MA are not exposed to lending risk and can scale their businesses without being weighed down by (cont.)

Figure 2: LHS Repurchases & RHS Dividend per Share



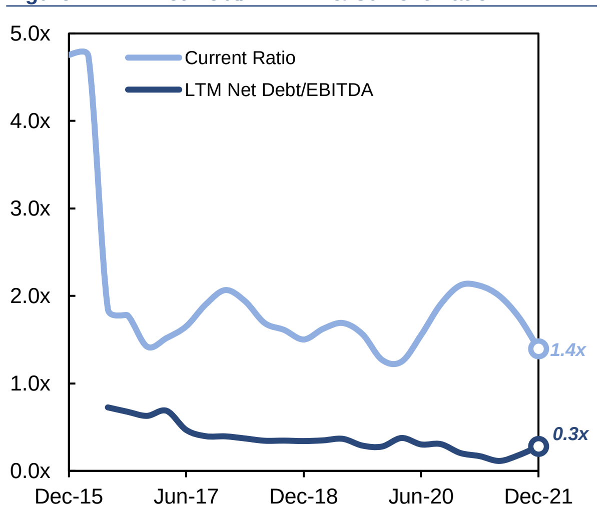
Source: S&P Capital IQ

Figure 3: LHS EBITDA Margin & RHS ROIC



Source: Bloomberg

Figure 4: LTM Net Debt/EBITDA & Current Ratio



Source: Bloomberg

lending exposure, explaining the lofted valuations relative to peers. While PYPL experiences similar tendencies, its role is different. PYPL primarily bridges the gap between consumers and merchants, often utilizing bank accounts or V/MA cards as a funding source. In January 2022, V and PYPL announced a partnership to further synergize their two businesses.

Growing trends in the consumer payments industry include a further shift to cashless transactions, the adoption of tap-to-pay and click-to-pay capabilities, and the disruption of buy-now-pay-later (BNPL) platforms and digital wallets. Analysts predict that 13% of all online transactions will utilize BNPL loans by 2025, nearly doubling in growth off a 2021 base year. However, growing delinquencies among BNPL users may inhibit the service's growth.

Growth Strategy

The Company has identified three areas to bolster revenue growth: consumer payments, new flows, and value-added services.

V plans to target the US$18T in global consumer spending that is still conducted in cash and cheque to move these transactions to its networks. The Company has also been developing its cryptocurrency capabilities, looking to serve as a bridge between cryptocurrency networks and V's global payments network. In FY2021, V had US$3.5B in payments volume on crypto-linked card programs, which are crypto wallets linked to V credentials.

New flows represent a US$185T global payments volume opportunity. Addressing this market involves facilitating person-to-person (P2P), business-to-consumer (B2C), business-to-business (B2B), business-to-small business (B2b), and government-to-consumer (G2C) capital flows. The Company plans to serve these markets through its Visa Direct and Visa Business Solutions offerings. For cross-border B2B transactions, V has developed Visa B2B Connect, which facilitates transactions from the bank of origin to the beneficiary bank, negating SWIFT payments and removing the need for an intermediary bank to process payments. What this means is that critical, high-sum transactions are processed quicker, enabling better-informed business decisions.

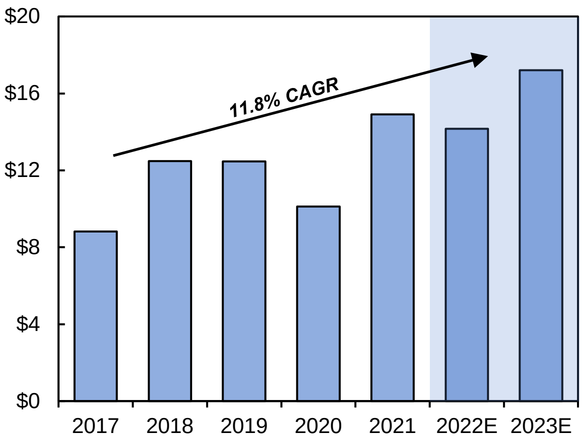
Within V's value-added services, it now offers its own solutions to installment payments: Visa Installments. It plans to partner with existing BNPL platforms that use V's cards and services to provide more installment options. In addition, this service allows V-product-issuing banks to offer installment options to V cardholders at the time of transaction.

Mandate Fit

Quality Management: Alfred Kelly has held the position of CEO since December 2016, previously acting as President and CEO at Intersection, a technology and digital media company. Despite what appears to be a seemingly unconventional foray into the payment space, Mr. Kelly had spent most of his career (23 years) at AXP, where he held several senior positions. The Company's compensation program targets 94% and 92% of pay to be at-risk for the CEO and other NEOs, respectively (with the remaining 6% and 8% representing compensation in the form of salary). For the CEO, target at-risk pay is comprised of 84% target long-term incentives (stock options, restricted stock units, and performance shares), and 16% cash-based annual incentives.

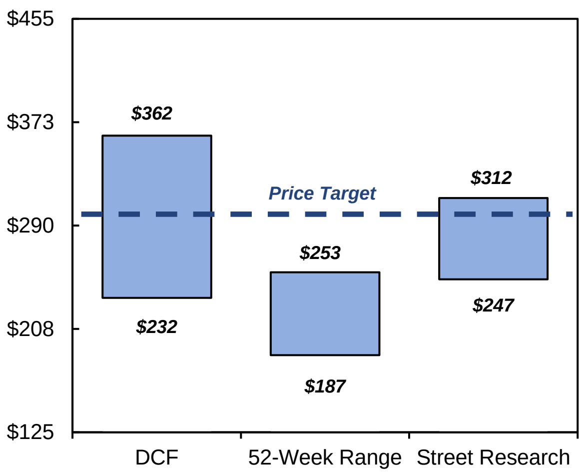
Competitive Advantage: Riding the secular shift to electronic payments, the Company has experienced growing barriers to entry due to "network effects". Essentially, as more individuals (cont.)

Figure 5: Free Cash Flow (US$B)



Source: Company Filings, CPMT Estimates

Figure 6: Valuation Summary (US$)



Source: Bloomberg, CPMT Estimates, Street Research

connect to the payment network, the more attractive it becomes to merchants, resulting in a snowball effect. In conjunction with an asset-light, highly scalable business model, V enjoys a best-in-class LTM EBIT margin of 66.5%, fueling LTM ROIC and ROE of 19.5% and 39.3%, respectively.

Balance Sheet: As of YE2021, the Company had US$20.9B of debt on its balance sheet, offset by US$14.7B of cash and equivalents, resulting in net debt of US$6.2B. Operating at a LTM Net Debt/EBITDA of 0.3x, this raises no concern to the Fund. V's primary source of liquidity is its cash on hand and significant free cash flow which will suffice for the Company's projected needs over the next 12 months. However, if additional liquidity is required, V has US$1.5B of liquidable current investments, US$3.0B of commercial paper capacity, and a US$5.0B revolving credit facility. V holds investment grade credit ratings of AA- and Aa3 from S&P and Moody's, respectively. The Company boasts a superb balance sheet, thanks to its asset-light business model and significant cash flow generation capabilities.

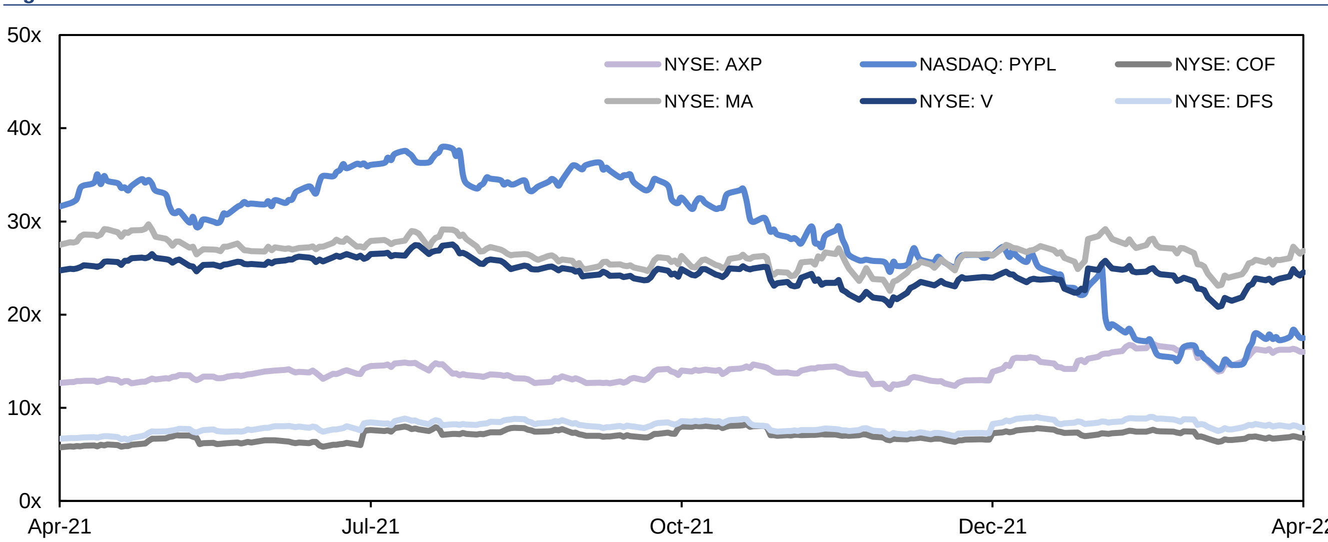
Growing Free Cash Flow: Over a five-year period (2017 - 2021), the Company produced a FCF CAGR of 14%. Including the CPMT's 2022 and 2023 projections, the Fund believes that this will translate to a 11.8% CAGR, reduced by the absence of substantial COVID-19-induced consumer spending increases that occurred over 2021.

Investment Thesis and Valuation

The CPMT valued V using a 10-year DCF analysis with a WACC of 7.2%. The valuation consisted of a 50/50 blend of (1) the Gordon Growth method (using a terminal growth rate of 1.5%) and (2) the application of a 20.0x EV/EBITDA exit multiple, yielding a target price of $290.

While V/MA trades at a premium to the broader peer group (excluding PYPL), V has historically traded at a ~2x NTM EV/EBITDA discount to MA. Both companies are heavily investing in expanding their TAM by addressing new flows, however, the Fund believes that V is better positioned to dominate this strategy as its larger scale (82% more payment volume in 2021) enables more banking partnerships and enhances its M&A strategy. Correspondingly, the Fund expects V to experience modest multiple expansion as this valuation gap tightens.

Figure 7: NTM EV/EBITDA vs Peers



Source: Bloomberg