1BN) Visa Beats JPMorgan as Cards Wage War on Cash: Riskless Ret urn

+--+

Visa Beats JPMorgan as Cards Wage War on Cash: Riskless Return
2012-05-30 04:00:18.1 GMT

By Dakin Campbell

May 30 (Bloomberg) -- Visa Inc. and MasterCard Inc., the biggest bank-card networks, produced better risk-adjusted returns than 81 publicly traded U.S. financial firms as the two benefit from a long-term global shift to electronic payments.

Shares of Visa and MasterCard outperformed every company in the Standard & Poor's 500 Financials Index during the past year, according to the BLOOMBERG RISKLESS RETURN RANKING. Visa, based in San Francisco, returned 1.59 percent after adjusting for price swings in the 12 months ended last week, helped by a volatility that was lower than that of two-thirds of the stocks in the index. MasterCard climbed 1.18 percent.

The networks route payments and guarantee settlement, and both have more than doubled revenue in the past six years amid a consumer shift from cash to electronic payments that shows no signs of abating. They don't lend money, avoiding the profit squeeze banks face from record-low rates, and they're subject to less regulatory scrutiny than lenders or insurers, insulating their stocks from sharper price swings, analysts said.

"They are very sophisticated toll collectors," said Darrin Peller, an analyst with Barclays Plc. "It's a very profitable group that's very capable of managing and controlling their earnings power."

Visa and MasterCard aren't included in the S&P sub-index, though they're frequently compared to financial-services firms.

Discover Financial Services, the credit-card lender that also owns a payments network, had the index's second-highest risk- adjusted return after Simon Property Group Inc., the Indianapolis-based real estate investment trust.

Apple, JPMorgan

Visa and MasterCard are part of the 70-company S&P 500 Information Technology Index, and ranked second and third for risk-adjusted returns after Apple Inc., based in Cupertino, California.

JPMorgan Chase & Co., which earlier this month reported a $2 billion loss tied to trades on illiquid credit derivatives, had risk-adjusted returns of negative 0.43. The New York-based lender, the biggest U.S. bank by assets, was 35 percent more volatile than Visa and 11 percent more than MasterCard.

Five of the six largest U.S. lenders were among the worst performers in the S&P financials index for risk-adjusted returns. JPMorgan, Bank of America Corp., Citigroup Inc., Goldman Sachs Group Inc. and Morgan Stanley ranked 62nd, 70th 71st, 76th and 77th, respectively. Only Wells Fargo & Co., which ranked ninth, had a positive risk-adjusted return.

'Places to Hide'

"Financial-dedicated investors have been looking for places to hide," said Benjamin Hesse, who manages five financial-stock funds and leads a team of 15 analysts at Boston- based Fidelity Investments. "In general, the payment networks have seen their model improve the most in financial services."

Erica Harvill, a Visa spokeswoman, JPMorgan's Joseph Evangelisti and MasterCard's James Issokson declined to comment.

The risk-adjusted return, which isn't annualized, is calculated by dividing total return by volatility, or the degree of daily price variation, giving a measure of income per unit of risk. A higher volatility means the price of an asset can swing dramatically in a short period, increasing the potential for unexpected losses.

Warren Buffett's Berkshire Hathaway Inc. has taken stakes in Visa and MasterCard as investment manager Todd Combs, who ran a hedge fund focused on financial stocks before joining Berkshire in 2010, builds his portfolio. Berkshire owned almost
2.9 million Visa shares and 405,000 MasterCard shares as of March 31, Omaha, Nebraska-based Berkshire said in a regulatory filing.

American Express

Buffett, the billionaire who said he invests in companies with durable competitive advantages, also is the biggest shareholder of credit-card lender and payments-network operator American Express Co. New York-based AmEx's risk-adjusted return for the year ended May 25 was 0.38 percent, ranking it 13th out of the 81 firms in the S&P financials index.

The Federal Reserve completed rules on debit-card fees and processing last year as part of the Dodd-Frank Act. That helped to reduce volatility for Visa and MasterCard as it eliminated uncertainty that had persisted since the law was enacted a year earlier, according to Alison Williams, a senior analyst with Bloomberg Industries in Skillman, New Jersey.

U.S. banks, meanwhile, are still haggling with regulators over Dodd-Frank provisions including the so-called Volcker rule, which limits lenders from making bets with their own money. The new Consumer Financial Protection Bureau is reviewing lending practices and global regulators are weighing stricter capital standards.

'Regulatory Clarity'

"There's a lot more regulatory clarity for this industry as compared with broader financials," Williams said of the payment networks. "These companies that don't lend and don't make money through the use of their balance sheet are not going to have the same risk to returns."

An increase in consumer spending in emerging markets such as Brazil and India has fueled profit growth for Visa and MasterCard, which also are benefitting as governments embrace electronic payments to boost tax receipts and fight corruption.

Visa agreed in December to assist Rwanda in developing a payments system, an initiative that may help Chief Executive Officer Joseph W. Saunders, 66, fulfill a goal of generating more than half of the firm's revenue outside the U.S. by 2015.

MasterCard CEO Ajay Banga, 52, whose company reaped 60 percent of its revenue abroad last year, has repeatedly reminded investors of his "war on cash."

Consumers worldwide spent $11.2 trillion on credit and debit cards last year, an increase of more than 18 percent from a year earlier, according to the Nilson Report, an industry newsletter based in Carpinteria, California. Visa and MasterCard accounted for $7.81 trillion of those purchases.

Room for Growth

Even in the U.S., whose payment system is more mature that those in the developing world, there's more room for growth.

Card- and electronic-based payments are projected to account for
69 percent of all U.S. consumer payments in 2015, up from 61 percent in 2010 and 50 percent in 2005, according to Nilson.

About 85 percent of the world's payments are still made in cash and checks, MasterCard said in a Sept. 15 presentation.

Visa posted net income of $1.29 billion on revenue of $2.58 billion for the three months ended March 31 and forecast annual earnings-per-share growth as high as the “low twenties,” the company said in a statement. MasterCard’s first-quarter profit surged 21 percent to $682 million.

The networks still may be forced to trim their fees and defend their market dominance as regulators worldwide continue to scrutinize their business models and smartphones change the competitive landscape.

Mobile Wallets

Apple, Google Inc. and EBay Inc.’s PayPal unit are developing so-called mobile wallets to capture spending flows.

Wal-Mart Stores Inc. and Target Corp. also are working to start a mobile-payments venture, the Wall Street Journal reported in March. Retailers, who accused Visa and MasterCard of being an unregulated duopoly that gouges merchants, helped push through the U.S. debit regulations. Visa this month disclosed a U.S.
antitrust probe into its pricing for debit-card transactions.

Visa, MasterCard and card-issuing banks also are defendants in a federal antitrust lawsuit alleging price-fixing on credit- card transactions, and U.S. lawmakers have considered legislation similar to the debit-card caps. Last week, MasterCard lost a court challenge seeking to overturn a European Union decision that the company’s cross-border card fees violated antitrust rules.

Still, analysts predict further gains. Visa may report revenue will climb 9.3 percent to $2.82 billion for the three months ending March 2013, while MasterCard’s may advance 13 percent to $1.99 billion, according to the average estimates of analysts surveyed by Bloomberg.

As card spending climbs, the networks can generate profit margins of more than 90 percent on each additional purchase since the technology is already installed, said Peller, the Barclays analyst. That means steady profits, he said.

For Visa and MasterCard, “if I was allowed to, I would put both stocks in my personal account and forget about them for the next four or five years,” he said.

For Related News and Information:
Day’s best/worst financial stocks: S15FINL <Index> MRR1 <GO> Financial stocks this year: S5FINL <Index> GP YTD <GO> Financial company news: FTOP <GO> Credit & Debit: BI CARD <GO>

--Editors: Peter Eichenbaum, Rick Levinson

To contact the reporter on this story:
Dakin Campbell in San Francisco at +1-415-617-7174 or dcampbell27@bloomberg.net

To contact the editors responsible for this story:
David Scheer at +1-212-617-2358 or
dscheer@bloomberg.net;
Christian Baumgaertel at +1-617-210-4624 or cbaumgaertel@bloomberg.net