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Mastercard Inc
Form 10-Q
July 27, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
☒ 1934

For the quarterly period ended June 30, 2017

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934

For the transition period from _____ to _____

Commission file number: 001-32877

Mastercard Incorporated
(Exact name of registrant as specified in its charter)

Delaware 13-4172551
(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification Number)

2000 Purchase Street 10577
Purchase, NY (Zip Code)
(Address of principal executive offices)
(914) 249-2000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ (do not check if a smaller reporting company) Smaller reporting company ☐

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards ☐ provided pursuant to Section 13 (a) of the Exchange Act.

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒
As of July 24, 2017, there were 1,049,179,397 shares outstanding of the registrant's Class A common stock, par value \$0.0001 per share; and 15,717,897 shares outstanding of the registrant's Class B common stock, par value \$0.0001 per share.

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In this Report on Form 10-Q (“Report”), references to the “Company,” “Mastercard,” “we,” “us” or “our” refer to the Mastercard brand generally, and to the business conducted by Mastercard Incorporated and its consolidated subsidiaries, including our operating subsidiary, Mastercard International Incorporated.

Forward-Looking Statements

This Report contains forward-looking statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts may be forward-looking statements. When used in this Report, the words “believe”, “expect”, “could”, “may”, “would”, “will”, “trend” and similar words are intended to identify forward-looking statements. Examples of forward-looking statements include, but are not limited to, statements that relate to the Company’s future prospects, developments and business strategies.

Many factors and uncertainties relating to our operations and business environment, all of which are difficult to predict and many of which are outside of our control, influence whether any forward-looking statements can or will be achieved. Any one of those factors could cause our actual results to differ materially from those expressed or implied in writing in any forward-looking statements made by Mastercard or on its behalf, including, but not limited to, the following factors:

- payments system-related legal and regulatory challenges (including interchange fees, surcharging and the extension of current regulatory activity to additional jurisdictions or products)

- the impact of preferential or protective government actions

- regulation of privacy, data protection and security

- regulation to which we are subject based on our participation in the payments industry (including payments oversight, anti-money laundering and economic sanctions, financial sector oversight, issuer practice regulation and regulation of internet and digital transactions)

- potential or incurred liability and limitations on business resulting from litigation

- the impact of competition in the global payments industry (including disintermediation and pricing pressure)

- the challenges relating to rapid technological developments and changes

- the impact of information security failures, breaches or service disruptions on our business

- issues related to our relationships with our financial institution customers (including loss of substantial business from significant customers, competitor relationships with our customers and banking industry consolidation)

- the impact of our relationships with other stakeholders, including merchants and governments

- exposure to loss or illiquidity due to settlement guarantees and other significant third-party obligations

- the impact of global economic and political events and conditions (including global financial market activity, declines in cross-border activity, negative trends in consumer spending and the effect of adverse currency fluctuation)

- reputational impact, including impact related to brand perception, account data breaches and fraudulent activity

- issues related to acquisition integration, strategic investments and entry into new businesses

- issues related to our Class A common stock and corporate governance structure

Please see a complete discussion of these risk factors in Part I, Item 1A - Risk Factors of the Company’s Annual Report on Form 10-K for the year ended December 31, 2016. We caution you that the important factors referenced above may not contain all of the factors that are important to you. Our forward-looking statements speak only as of the date of this Report or as of the date they are made, and we undertake no obligation to update our forward-looking statements.

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PART I — FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

MASTERCARD INCORPORATED
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	June 30, 2017	December 31, 2016
	(in millions, except per share data)	
ASSETS		
Cash and cash equivalents	\$ 5,177	\$ 6,721
Restricted cash for litigation settlement	544	543
Investments	1,782	1,614
Accounts receivable	1,708	1,416
Settlement due from customers	1,271	1,093
Restricted security deposits held for customers	993	991
Prepaid expenses and other current assets	1,067	850
Total Current Assets	12,542	13,228
Property, plant and equipment, net of accumulated depreciation of \$650 and \$603, respectively	845	733
Deferred income taxes	375	307
Goodwill	2,759	1,756
Other intangible assets, net of accumulated amortization of \$1,058 and \$974, respectively	1,126	722
Other assets	2,192	1,929
Total Assets	\$ 19,839	\$ 18,675
LIABILITIES, REDEEMABLE NON-CONTROLLING INTERESTS AND EQUITY		
Accounts payable	\$ 654	\$ 609
Settlement due to customers	1,106	946
Restricted security deposits held for customers	993	991
Accrued litigation	736	722
Accrued expenses	3,306	3,318
Other current liabilities	788	620
Total Current Liabilities	7,583	7,206
Long-term debt	5,326	5,180
Deferred income taxes	140	81
Other liabilities	842	524
Total Liabilities	13,891	12,991
Commitments and Contingencies		
Redeemable Non-controlling Interests	70	—
Stockholders' Equity		
Class A common stock, \$0.0001 par value; authorized 3,000 shares, 1,379 and 1,374 shares issued and 1,051 and 1,062 outstanding, respectively	—	—
Class B common stock, \$0.0001 par value; authorized 1,200 shares, 16 and 19 issued and outstanding, respectively	—	—
Additional paid-in-capital	4,257	4,183

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Class A treasury stock, at cost, 329 and 312 shares, respectively	(18,911)	(17,021)
Retained earnings	21,205	19,418
Accumulated other comprehensive income (loss)	(699)	(924)
Total Stockholders' Equity	5,852	5,656
Non-controlling interests	26	28
Total Equity	5,878	5,684
Total Liabilities, Redeemable Non-controlling Interests and Equity	\$ 19,839	\$ 18,675

The accompanying notes are an integral part of these consolidated financial statements.

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MASTERCARD INCORPORATED
CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(in millions, except per share data)			
Net Revenue	\$3,053	\$2,694	\$5,787	\$5,140
Operating Expenses				
General and administrative	1,075	930	2,026	1,798
Advertising and marketing	214	184	384	319
Depreciation and amortization	111	93	203	188
Provision for litigation settlement	—	107	15	107
Total operating expenses	1,400	1,314	2,628	2,412
Operating income	1,653	1,380	3,159	2,728
Other Income (Expense)				
Investment income	14	10	29	20
Interest expense	(39)	(22)	(78)	(42)
Other income (expense), net	—	(3)	(4)	(4)
Total other income (expense)	(25)	(15)	(53)	(26)
Income before income taxes	1,628	1,365	3,106	2,702
Income tax expense	451	382	848	760
Net Income	\$1,177	\$983	\$2,258	\$1,942
Basic Earnings per Share	\$1.10	\$0.89	\$2.10	\$1.76
Basic Weighted-Average Shares Outstanding	1,070	1,098	1,074	1,104
Diluted Earnings per Share	\$1.10	\$0.89	\$2.09	\$1.75
Diluted Weighted-Average Shares Outstanding	1,075	1,101	1,078	1,107

The accompanying notes are an integral part of these consolidated financial statements.

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MASTERCARD INCORPORATED
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
	2016	2017	2016	2017
	(in millions)			
Net Income	\$1,177	\$983	\$2,258	\$1,942
Other comprehensive income (loss):				
Foreign currency translation adjustments	230	(89)	316	5
Income tax effect	2	(7)	1	(5)
Foreign currency translation adjustments, net of income tax effect	232	(96)	317	—
Translation adjustments on net investment hedge	(108)	28	(142)	(36)
Income tax effect	40	(9)	52	13
Translation adjustments on net investment hedge, net of income tax effect	(68)	19	(90)	(23)
Defined benefit pension and other postretirement plans	—	(1)	(2)	(1)
Income tax effect	—	—	1	—
Defined benefit pension and other postretirement plans, net of income tax effect	—	(1)	(1)	(1)
Investment securities available-for-sale	(1)	2	(2)	5
Income tax effect	1	(1)	1	(2)
Investment securities available-for-sale, net of income tax effect	—	1	(1)	3
Other comprehensive income (loss), net of tax	164	(77)	225	(21)
Comprehensive Income	\$1,341	\$906	\$2,483	\$1,921

The accompanying notes are an integral part of these consolidated financial statements.

MASTERCARD INCORPORATED
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(UNAUDITED)

	Stockholders' Equity						
	Common Stock Class A B	Retained Earnings	Other Comprehensive Income (Loss)	Additional Paid-In Capital	Class A Treasury Stock	Non- Controlling Interests	Total Equity
	(in millions, except per share data)						
Balance at December 31, 2016	\$—	\$19,418	\$ (924)	\$ 4,183	\$(17,021)	\$ 28	\$5,684
Net income	—	2,258	—	—	—	—	2,258
Activity related to non-controlling interests	—	—	—	—	—	(2)	(2)
Other comprehensive income (loss), net of tax	—	—	225	—	—	—	225
Cash dividends declared on Class A and Class B common stock, \$0.44 per share	—	(471)	—	—	—	—	(471)
Purchases of treasury stock	—	—	—	—	(1,894)	—	(1,894)

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Share-based payments	—	—	—	74	4	—	78
Balance at June 30, 2017	\$—	—\$21,205	\$ (699)	\$ 4,257	\$(18,911)	\$ 26	\$5,878

The accompanying notes are an integral part of these consolidated financial statements.

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MASTERCARD INCORPORATED
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	Six Months Ended June 30, 2017 2016 (in millions)	
Operating Activities		
Net income	\$2,258	\$1,942
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of customer and merchant incentives	496	396
Depreciation and amortization	203	188
Share-based compensation	88	74
Tax benefit for share-based payments	—	(33)
Deferred income taxes	(23)	(8)
Other	35	(28)
Changes in operating assets and liabilities:		
Accounts receivable	(186)	(100)
Settlement due from customers	(177)	75
Prepaid expenses	(980)	(522)
Accrued litigation and legal settlements	14	107
Accounts payable	24	(18)
Settlement due to customers	159	(50)
Accrued expenses	(4)	—
Net change in other assets and liabilities	132	96
Net cash provided by operating activities	2,039	2,119
Investing Activities		
Purchases of investment securities available-for-sale	(322)	(561)
Purchases of investments held-to-maturity	(514)	(139)
Proceeds from sales of investment securities available-for-sale	105	107
Proceeds from maturities of investment securities available-for-sale	248	162
Proceeds from maturities of investments held-to-maturity	461	130
Purchases of property, plant and equipment	(114)	(101)
Capitalized software	(54)	(80)
Acquisition of businesses, net of cash acquired	(951)	—
Investment in nonmarketable equity investments	(121)	(11)
Other investing activities	8	(2)
Net cash used in investing activities	(1,254)	(495)
Financing Activities		
Purchases of treasury stock	(1,893)	(1,819)
Payment of debt	(64)	—
Dividends paid	(474)	(421)
Tax benefit for share-based payments	—	33
Tax withholdings related to share-based payments	(46)	(52)
Cash proceeds from exercise of stock options	36	16
Other financing activities	(11)	(3)
Net cash used in financing activities	(2,452)	(2,246)
Effect of exchange rate changes on cash and cash equivalents	123	51
Net decrease in cash and cash equivalents	(1,544)	(571)

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Cash and cash equivalents - beginning of period	6,721	5,747
Cash and cash equivalents - end of period	\$5,177	\$5,176

The accompanying notes are an integral part of these consolidated financial statements.

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MASTERCARD INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Summary of Significant Accounting Policies

Organization

Mastercard Incorporated and its consolidated subsidiaries, including Mastercard International Incorporated (“Mastercard International” and together with Mastercard Incorporated, “Mastercard” or the “Company”), is a technology company in the global payments industry that connects consumers, financial institutions, merchants, governments and businesses worldwide, enabling them to use electronic forms of payment instead of cash and checks. The Company facilitates the switching (authorization, clearing and settlement) of payment transactions, and delivers related products and services. The Company makes payments easier and more efficient by creating a wide range of payment solutions and services through a family of well-known brands, including Mastercard®, Maestro® and Cirrus®. The Company also provides value-added offerings such as safety and security products, information services and consulting, issuer and acquirer processing, and loyalty and reward programs. The Company’s network is designed to ensure safety and security for the global payments system. A typical transaction on the Company’s network involves four participants in addition to the Company: cardholder (an individual who holds a card or uses another device enabled for payment), merchant, issuer (the cardholder’s financial institution) and acquirer (the merchant’s financial institution). The Company’s customers encompass a vast array of entities, including financial institutions and other entities that act as “issuers” and “acquirers”, as well as merchants, governments, and other businesses. The Company does not issue cards, extend credit, determine or receive revenue from interest rates or other fees charged to cardholders by issuers, or establish the rates charged by acquirers in connection with merchants’ acceptance of the Company’s branded cards.

Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of Mastercard and its majority-owned and controlled entities, including any variable interest entities (“VIEs”) for which the Company is the primary beneficiary. At June 30, 2017 and December 31, 2016, there were no significant VIEs which required consolidation. The Company consolidates acquisitions as of the date in which the Company has obtained a controlling financial interest. Intercompany transactions and balances have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the 2017 presentation. The Company follows accounting principles generally accepted in the United States of America (“GAAP”).

The balance sheet as of December 31, 2016 was derived from the audited consolidated financial statements as of December 31, 2016. The consolidated financial statements for the three and six months ended June 30, 2017 and 2016 and as of June 30, 2017 are unaudited, and in the opinion of management, include all normal recurring adjustments that are necessary to present fairly the results for interim periods. The results of operations for the three and six months ended June 30, 2017 are not necessarily indicative of the results to be expected for the full year.

The accompanying unaudited consolidated financial statements are presented in accordance with the U.S. Securities and Exchange Commission requirements for Quarterly Reports on Form 10-Q. Reference should be made to the Mastercard Incorporated Annual Report on Form 10-K for the year ended December 31, 2016 for additional disclosures, including a summary of the Company’s significant accounting policies.

Non-controlling interest amounts are included in the consolidated statement of operations within other income (expense). For the three and six months ended June 30, 2017 and 2016, activity from non-controlling interests was not material to the respective period results.

Recent Accounting Pronouncements

Net periodic pension cost and net periodic postretirement benefit cost - In March 2017, the Financial Accounting Standards Board (“FASB”) issued accounting guidance to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost. Under this guidance, the service cost component is required to be reported in the same line item as other compensation costs arising from services rendered by employees during the period. The other components of the net periodic benefit costs are required to be presented in the consolidated statement of operations separately from the service cost component and outside of operating income. This guidance is required to be applied retrospectively. This guidance is effective for periods beginning after December 15, 2017, and interim periods within those years, with early

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

adoption permitted. The Company will adopt this guidance effective January 1, 2018. The Company is in the process of evaluating the impacts this guidance will have on its consolidated financial statements.

Goodwill impairment - In January 2017, the FASB issued accounting guidance to simplify how companies are required to test goodwill for impairment. Under this guidance, step 2 of the goodwill impairment test has been eliminated. Step 2 of the goodwill impairment test required companies to determine the implied fair value of the reporting unit's goodwill. Under this guidance, companies will perform their annual, or interim, goodwill impairment test by comparing the reporting unit's carrying value, including goodwill, to its fair value. An impairment charge would be recorded if the reporting unit's carrying value exceeds its fair value. This guidance is required to be applied prospectively and is effective for periods beginning after December 15, 2019, with early adoption permitted. The Company adopted this guidance effective January 1, 2017 and there was no impact from the adoption of the new accounting guidance on its consolidated financial statements.

Restricted cash - In November 2016, the FASB issued accounting guidance to address diversity in the classification and presentation of changes in restricted cash on the consolidated statement of cash flows. Under this guidance, companies will be required to present restricted cash and restricted cash equivalents with cash and cash equivalents when reconciling the beginning-of-period and end-of-period amounts shown on the consolidated statement of cash flows. This guidance is required to be applied retrospectively and is effective for periods beginning after December 15, 2017, with early adoption permitted. The Company will adopt this guidance effective January 1, 2018. Upon adoption of this standard, the Company will include restricted cash, which currently consists primarily of restricted cash for litigation settlement and restricted security deposits held for customers in its reconciliation of beginning-of-period and end-of-period amounts shown on the consolidated statement of cash flows.

Intra-entity asset transfers - In October 2016, the FASB issued accounting guidance to simplify the accounting for income tax consequences of intra-entity transfers of assets other than inventory. Under this guidance, companies will be required to recognize the income tax consequences of an intra-entity asset transfer when the transfer occurs. This guidance must be applied on a modified