Fleetcor Technologies Inc. (FLT)

Company Description
Fleetcor is the largest fuel payment network in the world, used by fleets of all sizes to buy fuel across a network of fuel stations, and to provide tools to limit spending types, track purchases, track mileage, etc. In addition, Fleetcor provides other services like B2B Payments, Brazil tolling, a lodging network, and gift card services.

Revenue Profile
The company reports financials in two main geographies (North America and International), as well as six main operating segments, as outlined below.

- **Fuel (~44% of revenue):** Offers fuel payment solutions to vehicle fleets, major oil companies, leasing companies and fuel markets. Their fuel payment products are most often in the form of plastic cards, but also include electronic RFID tags, mobile apps and paper vouchers. They earn a spread based on the fuel price.

- **Corporate Payments (~18% of revenue):** Offers corporate payment solutions to help customers streamline and manage their payments. The primary products are virtual cards, purchasing cards, T&E cards, payroll cards, and cross-border payment facilitation. They are the largest virtual card issuer (does more in virtual card payments as the top 4 banks combined) and has the largest network of accepting merchants. They earn ~70bps yield on the spend volume.

- **Tolls (~13% of revenue):** Owns the largest toll business in Brazil (second largest toll business in the world) and provides consumers with tolling tags that are used to pay for tolls. FLT estimates they collect ~90% of all electronic tolls in Brazil and nearly 70% of all tolls run through their network. They earn ~$5-$6/month per tolling tag.

- **Lodging (~9% of revenue):** Helps customers reserve hotel rooms by offering discounted rates within their network of hotels. FLT’s network of ~25k hotels helps reserve ~17 million nights at hotels with ~$1.4 billion of spend volume at those hotels. They earn ~$10 spread per night reservation.

- **Gift (~6% of revenue):** Provides gift cards and related services to some of the largest retailers. They provide services in more than 50 countries and processed around 1.3 billion transactions. This business was created when FLT acquired Comdata in 2014. They earn ~$0.13/transaction.

- **Other (~10% of revenue):** Offers two main payment products, including a fleet maintenance offering (UK) and employee benefit payments (Mexico and Brazil).

Competition

- **Competitors to fuel payment products:** Compete with independent fuel card issuers, major oil companies and petroleum marketers. Excluding major oil companies, their most significant competitors include WEX, U.S. Bank Voyager Fleet Systems, World Fuel Services, Edenred, Sodexo, Alelo, DKV, and Radius Payment Solutions.

- **Corporate Payments market dynamics:** Customers benefit include outsourcing their payables to FLT, reducing corporate expenses related to corporate payments. Since FLT manages all payments and vendor requests, customers benefit from not having to manage their payables.

- **Tolls market dynamics:** In Brazil, roads are largely owned by private companies who are in charge of building, improving, and maintaining the roads to current standards. In return, these private companies are able to charge tolls on their roads as a source of revenue. This is different compared to the US where roads are owned by the federal/state governments, who outsource the building, improvement and maintenance work to other companies.
Lodging market dynamics: The average occupancy rate in the US is ~70%, which is why hotels are willing to work with FLT. They do not have any business in Europe because the average occupancy rate is closer to 90-95%, making it less necessary for hotels to sell rooms at a discount. Customers are able to see FLT’s rate compared to the rates hotels provide, thus, they are able to see the potential savings with booking through FLT.

Gift market dynamics: Gift card usage typically grows ~5% each year, roughly offset by price pressure. The larger, national retailers typically have more pricing power because they drive more volume, whereas the smaller retailers have less pricing risk for FLT. Most of the gift card business remains in physical plastic, though some retailers are starting to expand their online gift card business. Other competitors in the market include FDC and VNTV (both provide bundled services with their acquiring services).

Quick Summary
- Q1 results were fairly solid considering COVID-19.
- Q1 Adjusted EPS of $3.00 was above consensus $2.83 (we were $2.80). Variance to our estimate was primarily due to revenue (+$0.13), margins (-$0.13), tax (+$0.07), shares (+$0.05), and interest/other (+$0.08).
- Q1 Revenue of $661 million was ~2% above consensus $647 million (we were $635 million). Organic constant-fx/fuel was ~5% decelerating from ~10% in Q4.
  - Fuel revenue of $292 million (we were $280 million); ~2% organic constant-fx/fuel growth (~9% in Q4; we expected ~2%).
  - Corporate Payments revenue of $120 million (we were $125 million); ~20% organic constant-fx/fuel growth (~14% in Q4; we expected ~12%).
  - Toll revenue of $83 million (we were $85 million); ~10% organic constant-fx growth (~17% in Q4; we expected ~13%).
  - Lodging revenue of $57 million (we were $49 million); ~5% organic constant-fx growth (~14% in Q4; we expected ~12% decline).
  - Gift revenue of $42 million (we were $46 million); ~12% organic constant-fx decline (~6% decline in Q4; we expected ~5% decline).
  - Other revenue of $67 million (we were $49 million); flattish organic constant-fx growth (~6% in Q4; we expected ~4%).
- 2020 guidance withheld on Q1 call given COVID-19 uncertainties
- Q2 guidance (provided on Q1 call): Management noted they expect Q2 to be the lowest in terms of volume and revenue. They expect April revenue to be down 20% to 25% yoy vs. April 2019 and expect volumes to begin to flatten. We break out their April trend commentary by segment on the following pages.
- Q3/Q4 commentary (provided on Q1 call): Noted as business activity starts to recover, volumes should build throughout the year, resulting in higher revenue/earnings in Q3/Q4
- Our $270 price target reflects ~20.5X our prospective EPS a year out of $13.10 (ending 6/30/22). This reflects a ~4% premium to the S&P's NTM P/E, mildly below 2017-2019 three-year average of 11% premium (range is -15% discount to 39% premium) given higher cyclical exposures than an average S&P company.

Investment Thesis
Payments growth. Participates in big long-term secular theme of electronic payments taking share from cash/check.

Competitive moat in fleet payment network. FLT and WEX have a large moat given the thousands of fuel stations and millions of vehicles served.

Other big network moats. Fleet has ~25k hotels and ~20k business customers in its lodging network. They collect ~90% of all electronic tolls in Brazil.

B2B payment opportunity could be large. The payments community and investors have big expectations for B2B payments in coming years. The big networks have indicated trillions of business payments that are largely made with checks. Fleetcor provides some corporate payment technology.

Strong incremental margins. Incremental transactions come on with limited costs.

 Acquisition strategy provides opportunity. The company has made 75+ acquisitions since 2002 and has executed very well. We believe there are many acquisition opportunities left and that this can continue to be a nice part of the company's growth.
Risks & Caveats

Fuel exposure. Fuel prices and volumes can become volatile as commodity prices fluctuate. The company estimated around 13% of 2019 revenue was directly influenced by the absolute price of fuel and around 5% of 2019 revenue was tied to fuel-price spreads.

Currency risk. Around 40% of revenue is generated in currencies other than the US dollar. The primary foreign currencies are the British pound, Brazilian real, Canadian dollar, Russian Ruble, Mexican Peso, Czech koruna, Euro, Australian dollar, and New Zealand dollar.

Acquisition integration. The company has acquired many companies over the years which take time and resources to integrate. Although they have a strong track record, the integration of recent and/or future acquisitions presents potential risk.

Railroad and trucking industry concentration. The company generates revenue from railroad and trucking customers through the Fuel and Lodging segments. Cyclicality in these industries could reduce demand and/or increase credit risk from these customers.

Gift card revenue lumpiness. A majority of revenue in this segment is from the design and purchase of gift card inventory from large US national retailers. This revenue tends to be lumper than the gift card processing fee revenue.

Travel sensitivity. We believe travel could be more cyclically sensitive than overall retail spending. If travel trends slow down, the company could see impacts to their Tolls and Lodging segments. Travel could also be impact by adverse weather.

Customer credit risk. The company establishes credit limits for their customers. These customers often include small to mid-sized businesses, which could become an increased credit risk during a downturn.

Regulatory risk. The FTC has filed a complaint against advertising/marketing practices, and we consider it possible that there could be some financial impact if FLT was required to make adjustments.

Supplemental Information

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<th>FLT Historical Trends Chart</th>
<th>Q1-19</th>
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*Source: Company Reports and Baird Estimates*
Appendix - Important Disclosures and Analyst Certification

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Rating and Price Target History for: Fleetcor Technologies Inc. (FLT) as of 05-15-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of FLT.

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