

20-Mar-2019

WEX, Inc. (WEX)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the WEX's Fourth Quarter 2018 Earnings Call. At this time, all participants are in a listen-only mode. Later we'll conduct a question-and-answer session and instructions will follow at the time. [Operator Instructions] As a reminder this conference call is being recorded.

I would now like to turn the conference over to your host, Mr. Steve Elder. You may begin, sir.

Steven Alan Elder

Senior Vice President, Global Investor Relations, WEX, Inc.

Thank you, sir, and good afternoon, everyone. With me today is Melissa Smith, our President and CEO; and our CFO, Roberto Simon. The press release we issued early today has been posted to the Investor Relations section of our website at wexinc.com. A copy of the release has also been included in an 8-K we submitted to the SEC.

As a reminder, we will be discussing non-GAAP metrics, specifically adjusted net income during our call. Adjustments for this year's third quarter and full year to arrive at this metric include unrealized gains and losses on financial instruments; net foreign currency re-measurement gains and losses; acquisition-related intangible amortization; other acquisition and divestiture-related items; stock-based compensation; restructuring and other costs and impairment charges; asset write-offs, gain on divestiture, debt restructuring and debt issuance cost amortization; non-cash adjustments related to our tax receivable agreement, similar adjustments attributable to non-controlling interests and certain tax-related items as applicable.

The company provides revenue guidance on a GAAP basis and earnings guidance on a non-GAAP basis, as we are unable to predict certain elements that are included in reported GAAP results. Please see Exhibit 1 of the

press release for an explanation and reconciliation of adjusted net income attributable to shareholders to GAAP net income attributable to shareholders.

I would also like to remind you that we will discuss forward-looking statements under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those forward-looking statements as a result of various factors, including those discussed in our press release and the risk factors identified in our annual report on Form 10-K filed with the SEC on March 18, 2019, and subsequent SEC filings.

While we may update forward-looking statements in the future, we disclaim any obligations to do so. You should not place undue reliance on these forward-looking statements, all of which speak only as of today.

With that, I'll turn the call over to Melissa Smith.

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

Good afternoon, everyone and thank you for joining us today. I'm excited to report a strong finish to 2018. We delivered fourth quarter revenue that exceeded the top-end of our guidance range and strong bottom-line results that grew 34% year-over-year. Revenue grew 15% to \$381 million compared to last year, making our 10th consecutive quarter of double-digit revenue growth. This includes strong revenue growth in our Fleet Solutions and Travel and Corporate Solutions segments as well as in our U.S. Healthcare business. The positive impacts of higher fuel prices, foreign exchange rates and the new revenue recognition standard and M&A activity were 6%.

On the bottom line, net income on a GAAP basis was \$0.49 per diluted share and adjusted net income was \$2.11 per diluted share. Overall, we executed well this quarter on the back of favorable macroeconomic conditions. Looking at the full year, 2018 was another record year for WEX. Revenue increased 20% to \$1.49 billion. GAAP net income per diluted share increased slightly to \$3.86 per diluted share, while adjusted net income per diluted share increased 56% to \$8.28. The full year earnings for 2017 and 2018 include adjustments to the preliminary results we announced on February 22 due to corrections of previously-disclosed errors relating to our Brazil operations as well as other immaterial corrections we identified during our review. Roberto will give some more details, but the changes to our preliminary 2019 guidance were not related to the issues we corrected for.

Our performance in 2018 was guided by the strategic pillars we set years ago that serve as the guidepost for our business. We remain committed to building upon our best-in-class growth engine, leading through superior technology, delivering scale through superior execution and leveraging our culture to attract and retain the best employees.

Executing against these pillars has allowed us to post another outstanding year underscored by record revenue, new and innovative products and strategic M&A that has expanded our penetration into the high-growth and dynamic corporate payments in consumer-directed healthcare markets. The progress made in 2018 is a testament to our ability to gain market share by deepening existing relationships, building new partnerships and delivering high-quality service and innovative technologies for expanding customer base, while executing on our acquisition strategy for long-term growth.

We continued to have significant new segment wins and contract renewals in the fourth quarter. In Fleet Solutions, revenue grew 15%, driven by higher volume growth, increased late fees and favorable macroeconomic tailwinds, including higher fuel prices. Our strong track record of new contract wins and partnership renewals gained momentum in 2018. For example, we signed new fleet contracts with RailCrew Xpress and [ph] Aeromar Canada (00:06:15) and also renewed significant contracts with Element Financial and Enterprise Rental. In the

over-the-road business, we had one of our best implementation quarters in the history of the business, including Horizon Transport and CFI.

We also made significant progress on the implementation and integration of several large higher-contract wins, most notably Shell and Chevron portfolios. Both conversions are progressing, and I'm pleased to report that the new WEX cards have been issued to all customers of the two portfolios. We're now in a transition period as customers convert to the new products in the accounts receivable balances rollover to us which we expect to be completed in the next several months. We remain well-positioned to win new business and generate organic revenue growth. Our best-in-class marketing and sales teams are helping us to capture additional market share.

In addition to wins and renewals, the service and support we provide our customers day-in and day-out truly differentiates us from our peers. One example of this is our ExxonMobil portfolio, which has had one of its best years ever in terms of new account growth in the U.S.

In Travel and Corporate Solutions, we closed out the year with an impressive 29% increase in revenue during Q4. This was driven by strengthening our relationships with industry-leading online travel agencies, while penetrating further into the rapidly-growing corporate payments space. We had \$8.2 billion in purchase volume this quarter, which is an increase that's, more than \$800 million over last year. Approximately 45% of this increase came in our corporate payments business.

In addition to our own sales efforts, our partnership strategy has proven to be successful and a strong revenue driver for us. One of these partners is American Express and we signed an agreement within Q3 for the use of our technology platform. Although we're still in the early-stages of this relationship, we're beginning to see increasing volumes as we get the program up and running.

We also had a handful of significant contract wins and renewals during the fourth quarter. One that I'm excited to announce is the signing of Swedish-based Etraveli, one of the largest OTAs in Europe, and the top 15 globally. Travel and corporate payments remains an important area for our future growth given the size and the underlying growth dynamics in the market. While we've had more than \$34 billion in purchase volume during 2018, there's still ample room for growth and we look forward to these opportunities in the coming year. As I mentioned in the November Investor Day, corporate payments will be a key area of focus for us in 2019 and beyond.

Moving on to the Health and Employee Benefit Solutions, our U.S. Healthcare business was robust and posted top-line growth of more than 12% in the quarter and 14% for the full year. In Health, we saw a successful open enrollment season, with a volume of transactions up 18% year-over-year and we closed 2018 with over 65 new or renewed partners. The service we offer our partners sets us apart from our competition and we continue to see 50% growth in the utilization of our mobile app and online partner portal. These tools continue to enhance the partner experience and the constant innovation that is the key to this success in this market.

Turning to new signings and renewals. We're pleased to announce that we have signed Associated Bank, Nova, Stanley Benefits and Voya Financial in the fourth quarter in additions to renewing a number of meaningful contracts. We now have more than 28 million consumers on the WEX Health Cloud platform.

I'd like to delve a little deeper in our second strategic pillar in the bedrock of our business, WEX's superior technology. We spent a significant amount of time over the past year adopting a cloud-first development process which we talked about at length in November. During Q4, we began migrating our fleet technology platform to the cloud. This is the first of many conversions over the next couple years. We're making great progress with little

disruption to our customers. Also in the Fleet segment, we're making progress towards consolidating processing platforms and have eliminated one platform this year. We plan to continue with this consolidation strategy.

We're also migrating the processing of our Travel products on to an internal cloud-based virtual card platform we call TAG, which was acquired as part of the 2017 AOC acquisition. We're starting to move our U.S. business on to TAG and have already processed over \$1.5 billion of transactions on a run rate basis in Q4. This too is completed with little to no disruption to our customers. As I talked about at our Investor Day in November, these moves to the cloud will allow us to improve performance and stability, increase the pace of product development and eventually deliver significant cost savings, which we're starting to see in our 2019 guidance.

Since we last spoke, we've acquired Discovery Benefits, one of the fastest-growing benefit solution providers in the marketplace with operations in all 50 states. We're particularly excited about this transaction as it expands our penetration into the attractive high-growth consumer-directed healthcare market, aligns with our growth strategy, including further diversifying the business away from fuel, complements and enhances our value proposition in the marketplace and provides significant cost synergies with long-term upside potential.

Ultimately, we believe this transaction strengthens WEX's position as a leading provider of innovative healthcare technology solutions; with greater size, scale and capability, we plan to successfully leverage our core technologies to improve our competitiveness in the CDH market and our strong platform for future acquisitions.

Before I wrap up my remarks, I also want to provide an update on the Noventis acquisition we closed in January. As a reminder, they're an electronic payment network and optimize the payment delivery process through their patented scalable technology. It complements our current offerings with new payment delivery capabilities that enhance AP payments and provides seamless delivery of electronic payments. This acquisition expands WEX reach as a corporate payments supplier and provides more channels to billing aggregators and financial institutions. We're on schedule to fully integrate Noventis into the WEX corporate payments platform by the end of this year. We're very excited about the new opportunities that we expect to capture in the years ahead.

As I look back at 2018, I am very pleased that we were able to execute against all of our strategic pillars. We've had revenue and earnings per share growth in line with our long-term targets. We again achieved recognition with Great Place to Work as rated by almost 90% of all WEX employees who filled out the survey. Finally, this year marked a year of significant technology milestones for WEX and we're excited to see what's next as we expand our capabilities. We've had huge wins in the marketplace, like Shell and Chevron. We had a very successful execution of the AOC integration, which surpassed our initial expectations. We've undertaken and made significant progress on digital transformation of our business, all while maintaining a corporate culture that supports our competitive advantage.

In summary, I'm very pleased with our performance in 2018. I'm proud of the foundations we've built through our investments over the past few years that will support long-term growth and value creation. Most of all, I'm thankful to all of our employees who are successfully executing on our strategic pillars and are the backbone of our company. We remain poised for growth in 2019, and I look forward to another successful year for WEX.

I'd now like to turn the call over to our CFO, Roberto Simon. Roberto?

Roberto Simon

Chief Financial Officer, WEX, Inc.

Thank you, and good afternoon, everyone. As Melissa mentioned earlier, I would like to provide you with an update on WEX's internal financial statement review. In addition, the recently filed 10-K, 10-K/A and press release contain updates to the preliminary results issued on February 22, 2019.

During the company's 2018 year-end thought process, WEX identified immaterial errors in the financial statements of our Brazilian subsidiary, which began before 2015 and are primarily related to accounts receivable and accounts payable. The financial statements have been corrected for these matters.

At the same time, we revised the financial statement to correct other immaterial variances impacting prior years that were not previously recorded. WEX believes that the effects of this revision is not material to our previously issued consolidated financial statements. We are actively engaged in the implementation of our remediation plan to ensure the controls are designed appropriately and will operate effectively.

Changing gears to the 2018 results, I want to pause for a moment to discuss the results for the full year. In 2018, WEX outperformed again with revenue growth of 20% and adjusted net income growth of 56% when compared to 2017. We had significant organic revenue growth in the business supplemented with M&A activity.

In the Fleet segment, revenue grew 18%. 10% of this relates to macroeconomic factors and revenue recognition. In the Travel and Corporate Solutions segment, revenue grew 35%. Approximately half of this growth was due to M&A and revenue recognition. Finally, the U.S. Health business grew 14%.

Now let's move to the Q4 results. We've had a strong organic revenue and adjusted net income growth driven by robust results from Fleet Solutions and Travel and Corporate Solutions segment. The U.S. Healthcare business also performed better-than-expected with solid revenue growth. From an earnings point of view, we continued to benefit from this organic growth, positive macroeconomic trends and a lower tax rate. Overall, we are pleased with the fourth quarter performance on both top and bottom-line results.

For the fourth quarter of 2018, our total revenue was \$381.2 million, a 15% increase over prior year. Non-GAAP adjusted net income was \$91.8 million, or \$2.11 per diluted share, up 34% from \$1.57, in line with guidance. I want to quickly point out that we are still benefiting from the new revenue recognition standards. The total benefit was \$10.9 million, which is similar to prior quarters.

Now, on to the segment results. The Fleet Solutions segment achieved \$253.8 million in revenue, an increase of 15% compared to prior year. Payment processing revenue increased 35% and finance fee revenue increased 10%. The gains were led by the North America Fleet business, which grew 14%, followed by the over-the-road, which grew 22%. Both of these growth rates benefited from higher fuel prices and the new revenue recognition standards. We also saw strong growth rates in Asia, up 59%; and Europe at 15%.

Within the Fleet segment, we continued to see solid organic transaction growth of 6.5%, driven by new sales. At the same time, we continued to maintain very low attrition rates. And finally, same-store sales were marginally negative due in part to the government shutdown.

The net interchange rate in Q4 was 138 basis points, which was up 20 basis points over the last year. There are three items that had a positive impact on the rate: a year-to-date revenue reclassification, higher [ph] fuel expense (00:20:32) from the European operations and the revenue recognition changes. Finally, in this segment, the average domestic fuel price in Q4 was \$2.94 versus \$2.68 in 2017. We have approximately \$13.5 million of additional revenue versus prior year due to higher fuel prices, including a spread impact in Europe.

Turning to our Travel and Corporate Solutions segment, we finished the year with the same strong momentum that we have all year. Total revenue for the quarter increased 29% versus last year, which was almost all organic.

Total purchase volume issued by WEX reached \$8.2 billion. This represents 11% organic growth and excludes AOC customers. Within the U.S., the Travel business remained steady with revenue growth of 13% and the corporate payments business was very strong with revenue growth, exceeding 100%. Lastly, the international business growth was led by Europe, Brazil and Australia.

The net interchange rate in the fourth quarter was 64 basis points, which was 11 basis points higher compared to Q4, 2017. The increase was due to customer volume mix, domestic and international spend mix and lower rebates.

Moving on to Health and Employee Benefit segment, the U.S. Health business surpassed expectations again, growing 4% year-over-year and continues to support its vigorous growth momentum. The average number of SaaS accounts was up 17% and total purchase volume was up 12%. The volume of transactions during open enrollment season was up 18% over the prior year and the pipeline remains strong. In the long-term, we continue to expect high-teens growth in this business.

As expected, we continue to see significant slowdown in the Brazilian Benefit's business. As a result, revenue in the Health and Employee Benefit Solutions segment decreased 4% in the quarter.

Let's now move to expenses. For the quarter, total cost of service expenses were \$137.6 million, up from \$126.4 million in Q4 last year. Total SG&A, depreciation and amortization expenses were \$149.8 million, which is up \$18.1 million.

Breaking down the line items within these categories, processing costs increased \$7.7 million primarily due to AOC and the onboarding costs for Shell and Chevron. Service fees were down \$1.7 million mainly due to the reclassification of network fees as part of the revenue recognition changes. Credit loss during the quarter was \$16.1 million, up from \$13.5 million a year ago. We recorded \$1.3 million expense related to the Brazil Benefit business.

In the Fleet segment, credit loss was at the low-end of the guidance, coming in at 12.2 basis points of spend volume. Operating interest was \$10.1 million. This is in line with expectations and was mostly due to higher fuel prices and interest rates. G&A expenses were up \$6.3 million for acquisition-related cost and legal expenses. Finally, sales and marketing expenses were up \$18.5 million, largely due to the new revenue recognition and the onboarding costs for Shell and Chevron.

Now on to discuss taxes. On a GAAP basis, the effective tax rate this quarter was 44.3%. On a non-GAAP basis, the ANI tax rate was 25% compared to 36% a year ago. The company continued to benefit from the tax reform.

I will now be discussing our balance sheet. We ended the quarter with \$541 million in cash, up from \$504 million at the end of last year. Our corporate cash balance at year-end stands at \$181 million after making the payment related to the acquisition of the Chevron portfolio. Additionally, we have approximately \$666 million available on the revolving line of credit, which give us access to more than \$800 million in capital. Also, at year-end we had a total balance of \$2.1 billion on the revolving line of credit, term loans and notes. The leverage ratio, as defined in our credit agreement, is standard approximately 3.1 times, down from 3.7 times at the end of last year.

As a reminder, we have been delevering as expected, since the time of the EFS acquisition at a rate of half a turn to three-quarters of a turn per year. During January, we announced that we can increase borrowing capacity and improve our financial covenants in order to fund acquisitions. When we pro forma for the Noventis and DBI transactions we expect the leverage ratio to be approximately 4 times.

We continue to see unrealized gains on the interest rate hedges we have in place. As of quarter-end, the market value of those hedges was \$18 million. We have \$250 million of hedges rolling off at the end of 2018. During much of the year, we have secured another \$450 million of interest rate hedges, locking in LIBOR at approximately 240 basis points. Including the debt from the DBI and Noventis deals, we expect to have about 65% of our financing debt balance essentially at fixed interest rates.

Finally, let's look at our guidance. Note that these expectations reflect our business up-to-date and are made on a non-GAAP basis with respect to adjusted net income. Before we get into the numbers, I want to give you some puts and takes that should be considered when modeling 2019. First and most important, the guidance is within our long-term targets of 10% to 15% growth in revenue and 15% to 20% growth in earnings. These targets assume constant fuel prices and FX rates.

Starting with the Fleet segment, our 2019 plans are notably higher than the long-term targets provided at the Investor Day for three key factors. First, we look to maintain strong transaction growth rates. Second, we anticipate to fully benefit from the Shell and Chevron portfolios in the second-half of the year. And third, we look forward to continued progress in international businesses.

As specific to the Shell and Chevron wins, I want to give you some details around the progression through the year. As Melissa said, we have mailed out that to all of the customers and we are beginning to see them transition onto our platform. It will take several months for this transition to be completed. Meanwhile, we are carrying significant costs as we did at the end of 2018, so we expect the two portfolios to be dilutive to earnings for the first half of this year and move to normal profitability when fully converted in the second half of the year and beyond. Finally, in this segment, we anticipate that fuel prices will be lower than 2018, negatively impacting revenue by approximately \$50 million.

Moving into the Travel and Corporate Solutions segment, revenue is expected to grow in excess of 30%, including approximately \$35 million from the Noventis acquisition. Excluding Noventis, we expect that revenue will be within our long-term guidance range of 10% to 15% growth. We also expect organic volume to grow in the mid-to-high teens.

Turning to the net interchange rate for the full year, we expect the rate to increase approximately 10 basis points versus the full-year rate in 2018. The main reasons for the increase are the acquisition of Noventis and the renegotiation of an OTA contract, which will shift revenue from other revenue to payment processing revenue.

Regarding the Health and Employee Benefit segment, we expect our U.S. Health business to grow revenue in the high-teens in line with expectations set at the Investor Day. Additionally, we expect approximately \$75 million in revenue as a result of the DBI acquisition, which closed earlier this month. As we said when we announced the deal, we do not expect a material impact on earnings this year.

In the Brazil Benefit business, we expect another challenging year.

Moving on to the financing side, we are assuming an increase in LIBOR of approximately 40 basis points on average from 2018. This increase would impact approximately \$900 million of floating rate debt, which includes

the debt for DBI and Noventis. In addition, we have approximately \$1.2 billion in deposit at our bank that will also be impacted by the higher interest rates.

Now, for our guidance numbers. We have updated our revenue range by \$50 million from our previously-issued revenue guidance. This includes an increase of approximately \$75 million for DBI. This also includes a \$25 million reduction from Noventis after concluding how the new revenue recognition standards will play to this transaction.

For the full year, we expect revenue to be in the range of \$1.68 billion to \$1.72 billion and adjusted net income in the range of \$385 million to \$403 million. On an EPS basis, we expect adjusted net income to be between \$8.80 and \$9.20 per diluted share.

For the first quarter, we expect revenue to be in the range of \$375 million to \$380 million and adjusted net income to be in the range of \$72 million to \$74 million. On an EPS basis, we expect adjusted net income to be between \$1.64 and \$1.70 per diluted share.

Now let me walk you through a few more assumptions. Exchange rates are based as of mid-February 2019. We assume that domestic fuel prices will average \$2.60 in the first quarter and \$2.63 for the full year. This assumption for the U.S. is based on the applicable NYMEX future price from the week of February 18.

The Fleet credit loss will be between 13 and 18 basis points, both for the first quarter and the full year. The company expects its 2019 adjusted net income tax rate for the full year to be between 24.5% and 26%.

And finally, we're assuming that there will be approximately 43.8 million shares outstanding for the year. To conclude, we are very confident about 2019 guidance and are looking forward to a great year.

And now we are opening the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Ramsey El-Assal from Barclays. Your line is open.

Ramsey El-Assal

Analyst, Barclays Capital, Inc.

Q

Hi, guys. Thanks for taking my question. Can you give us a little more color on the Brazil situation, sort of what happened there exactly? Was it just an accounting error, but there's no indication of any type of malfeasance or anything like that, or willful misstatements of past results? It's just simply an error that you've cleared up and now it's completely behind you. If you could provide a little bit more color there it would be appreciated.

Roberto Simon

Chief Financial Officer, WEX, Inc.

A

So, this is Roberto. Good afternoon. The majority of the issues we found in the Brazil Fleet was in the Brazil Fleet business. The processes we had were highly manual. And in the past two years we have been improving those processes over time. The other thing I would say to you is that finally the volume on this particular segment has declined significantly in the past two years. So this is why as we look into 2019 we feel comfortable on where we are.

Ramsey El-Assal

Analyst, Barclays Capital, Inc.

Q

Okay.

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

A

It's Melissa. I make sure that we respond to your second question too on – one of the things we did as part of this process is we engaged one of the Big Four firms to perform work for us. And we did not find any evidence of fraud or intent in errors and as part of that process just to make sure we're absolutely clear.

Ramsey El-Assal

Analyst, Barclays Capital, Inc.

Q

Okay. That's super helpful. Thanks so much. I wanted to ask also about your corporate payments growth rate, which was extraordinary. Can you give us a little more color in terms of what industry verticals there are driving that or solutions that you have that are driving that? And also, just bolted on to that, it looked like your credit loss expectations for 2019 were a little higher than your full year 2018 outlook, and I was just curious as to what is causing that to be elevated a little bit. Is it – increases it, is it on the credit side rather than the fraud side? Or any color there could help as well, and then I'll hop back in the queue.

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

A

Yeah, sure. Roberto actually gave some pretty good color on the corporate payments side. We actually, if you look across the portfolio, we saw great growth. But we saw oversized growth in some of the areas like the corporate payments [ph] itself (00:37:37). And more and more we think about that business we're segmenting it

between Travel and corporate payments. Corporate payments, it's a bigger market, it's got higher-growth rates. And we've been putting an increasing amount of capital and effort towards that space. So that's a piece of it, we're going off a relatively small base, which helps.

But that piece of it also grows outside of the United States as the businesses we've continued to globalize and we've added in and really strengthened up our European office. And you're seeing the benefit of that. I talked about one of the wins we just had in that space in Europe, and I think there's a direct correlation between the work we've done on the product, but also the work we've done in that office and making sure that we have really high talent that's focused on globalizing [ph] businesses (00:38:21).

Ramsey El-Assal

Analyst, Barclays Capital, Inc.

Great. Just the credit loss. Yeah.

Q

Roberto Simon

Chief Financial Officer, WEX, Inc.

Yes. This is Roberto. Let me take the credit loss question for you. Yeah, I mean, this is the way we see. So we closed 2018 with a 12.5 basis points of spend volume on the Fleet credit loss, and I guided 13 to 18 basis points. We don't expect any change from the 2018 results with just one exception that is related to the Shell and the Chevron portfolios. And here there are two pieces. Number one, these accounts have small businesses, which as you know, come with higher credit loss than the average North American Fleet business. And the second thing is, specifically to Shell, there is a revolver portfolio that also comes with a higher credit loss than the average of the business we have today.

A

Operator: Our next question comes from the line of Darrin Peller from Wolfe Research. Your line is open.

Darrin Peller

Analyst, Wolfe Research LLC

Thanks, guys. You continuously show mid-single-digit growth in your transaction levels in the Fleet segment, which, I guess, just give us a little more update on what you're seeing that's driving that level versus what we see at industry at some of your competitors. Is it – and then just maybe expand on sustainability to that as we get more organic going forward.

Q

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

Yeah. When we think about growth in that part of the business, there's a lot of blocking and tackling. As we continue to roll out products, we have sales people who are selling against both our partner portfolios and then directly. And over time, as we've added partners, it might be counterintuitive, but it actually helps build the ability to grow in the marketplace, because you have customers who have many different options and there's something unique about each brand, and we market to make sure that we're really being thoughtful about what people are attracted to about that brand. And that may be site acceptance, that may be something around brand loyalty; there's a whole host of reasons that people pick a particular product.

A

But that's an area of expertise of ours is to really understand what is going to drive somebody to that product to make sure that we're marketing to that. And at the same time, we have a WEX offering which gives people universality, if that's something that they're interested in alternatively.

And if you look across our partner portfolios, we had a really great growth year this year on behalf of our partners working in conjunction with them. And then the universal business has done well on the over-the-road business, and I talked about having one of the biggest implementations in the history of the over-the-road business.

I think that there's rich, really good momentum behind the fact that the technology was always good, but we've really added on to that with new products and features, and that's resonating in the marketplace.

Darrin Peller

Analyst, Wolfe Research LLC

Q

All right. Thanks. Melissa, you've mentioned I think 800 million gallons expected to roll on associated with Chevron and Shell through the year. First of all, is that still on target? And then just quick update on the trend on the overall integration and bringing those clients on. How's it been going?

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

A

That is still actually the target for us. And we have rolled out the cards. But what will happen with the customer base, they now have two cards in hand. They have cutover periods where we're starting to migrate those customers onto our platform. They have to go through a process that they're interested in being on the – using our online tools, which a lot of people are. Then they have to go through an activation process, but also a process of getting online. And so we're in the thick of that right now, but we're seeing that migration happen. We talked before about having those tranches executed by the first half of this year, and we're still on target to do that. So very much on target.

But Roberto pointed out this concept of dilution in the first half of the year. We tried to talk about that at the end of last year this idea that we've got costs that are going to come in advance of when we see revenue, and that's very normal for us as we go through our private-label implementation. It's a little bit abnormal to have queue stacked up of this size and so it's a little bit more accentuated than it normally would be. But the costs are there. The salespeople are out selling these new products. The customers have cards in hand. The tranches are converting over. We're seeing some volume coming through now, and so we feel very much on track to what we even said on our last call.

Darrin Peller

Analyst, Wolfe Research LLC

Q

Okay. All right, guys. Thanks.

Operator: Our next question comes from the line of Bob Napoli from William Blair. Your line is open.

Robert Napoli

Analyst, William Blair & Co. LLC

Q

Thank you, and good afternoon. First, on the Healthcare business with the acquisition of Discovery Benefits, WEX has well stated over the years, as increased its investment in Healthcare. Now this is a – the Discovery Benefits, I think that business was growing at a high rate, if you can – but it does bring up some questions of whether there's some conflict, channel conflict between Discovery Benefits and your other partners.

But if you could just talk a little bit about the investment in Discovery Benefits and the Healthcare business. And the high-teens growth is – are you seeing more of that from product basis, HSA, FSA? So just kind of a broad question there; conflict of interest and just the overall Healthcare business.

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

Sure.

A

Robert Napoli

Analyst, William Blair & Co. LLC

Sorry.

Q

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

Sure. Actually, I'd like to know – that's great. I like it actually – that's great after that last question. When we think about most channels, there's something that we do in every part of our business, and we're very conscience about how we go into a marketplace and how we make sure that we're transparent. I mean, when it comes down to going into a marketplace with partners indirectly, a lot of it's around creating rules of engagement and being transparent with people around what you're going to do. And then, making sure you follow through that.

A

And we have a very rich and deep history of making sure that we are supporting our partners, as well at the same time having the direct products. And as we think about this space, part of what we're interested in with DBI, you talked about the growth rates and that's certainly part of what's interesting to us as they've been growing better rate higher than our core Healthcare business historically.

And, at the same, time, it adds the product extension. We can sell some of the products that they have to our existing partners that they have an ability to use that into the marketplace. We can share best practices with some of what they're doing that we think that is unique with our partners and into the marketplace. And then, we have an ability to have an offering that is integrated into the marketplace, and we'd like that as a setup in the background, and – but we need to be able to show our partners in the marketplace that we can do that.

So from a complex perspective, that's something we intend to continue to work through with our partners in the way that we have in every other part of the business. And in terms of our interest in growth in this marketplace, it's got some great tailwinds behind it. We like the – just the market dynamics. We like the size of the market. We think that it is a market that healthcare, in general, is big, it's complicated. It's a place that we think that we can help, and you asked about the growth. It's kind of coming all over the place. When people think of FSA accounts as not growing, but they actually do. It's just growing at a lower rate. And then, you see oversized growth in the HSA side of the marketplace and it comes from adding in partners, spend volume going up, and the partners that we have continuing to grow, a combination of all of those things.

Robert Napoli

Analyst, William Blair & Co. LLC

Thank you. My follow-up question would be just on the economy. I mean, you saw FedEx report some weaker news. The Federal Reserve today said they're not going to raise rates anymore, so there's signs of global softness, but it doesn't sound like, I mean, you certainly didn't call out – I guess, same-store sales were a little weaker, but what are you seeing as far as the – what's your view on the economy?

Q

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

A

So same-store sales were negative [ph] 0.4% (00:47:42), so I'd say it really didn't see a significant change, and that was in the period where we had the government shutdown.

Robert Napoli

Analyst, William Blair & Co. LLC

Right. Okay.

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

But currently, as you can see, it's just letting through in some of our volume trends. So from our perspective, there hasn't really been much of a change. And what we're seeing for activity in the market and we think that our Fleet business is a pretty good – it's a pretty good view because we do business [ph] with different FSAs (00:48:14).

Robert Napoli

Analyst, William Blair & Co. LLC

Okay. So you're not seeing any slowdown in the economy, nothing that's worrying you. I guess and if I could sneak in the first-quarter guidance, and I know you talked about the dilution, but is that Shell/Chevron? Is that – can you quantify the EPS dilution in the first quarter?

Roberto Simon

Chief Financial Officer, WEX, Inc.

So, Bob, this is Roberto. Obviously, I'm not going to get a specific on how much is Shell and Chevron for the quarter, but if you position what we have been saying in the past few calls, I mean, those portfolios as Melissa said, they are big portfolios, they are going to bring a significant amount of revenue and to get them up to speed, there the onboarding cost of a business is significant. So I wouldn't quantify how much is the amount related to those portfolios, but it's a significant amount, obviously.

Robert Napoli

Analyst, William Blair & Co. LLC

Thank you.

Roberto Simon

Chief Financial Officer, WEX, Inc.

What I think is important – yeah, what I would say, Bob, what is important is the confidence on the guidance that we have for the full year, which is if we have a growth within our long-term target, and that's where we want to reinforce that and we're working towards that.

Robert Napoli

Analyst, William Blair & Co. LLC

All right. Thank you.

Operator: Our next question comes from the line of James Schneider from Goldman Sachs. Your line is open.

James Schneider

Analyst, Goldman Sachs & Co. LLC

Good afternoon and thank you taking my question. I was wondering if you could maybe talk a little bit more about the macro environment you're seeing, maybe by geography. It sounds like things are still pretty strong in Europe. But, I guess, maybe talk about either the difference between the U.S. and Europe. And, specifically, your expectations for new sales in Europe, outside of the new portfolio wins you've already talked about in the U.S.

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

A

Yeah. So when we're looking at any of our sales pipeline, we break down our year as we go into executing the year. We look at what retention rates need to be by products and by geo and then what we need from new sales coming in. And as we thought about that across the world, I guess that's what your question is, the U.S. marketplace, right now we're envisioning it's from an economic perspective, it being similar to last year. We know that we have at least two major implementations that we're executing on. So that's a little bit unusual on the backdrop. But it doesn't really impact – it's not affecting my view of the overall macro.

And then in Europe and Asia, I'd say similarly we've had really significant growth in those marketplaces during 2018, albeit off smaller base. But we don't envision that change when we look at how much we're going to bring in in 2019. There's a little bit more lumpiness as you bring in one large account. Like I talked about, that can cause a little bit more lumpiness just because of the size of the business. But in terms of new wins and what we're seeing in the pipeline, we feel pretty good across any of these markets.

And we talked about Brazil as being the one standout and the fact that we're expecting to have headwinds there this year, which is something we talked about the last two or three calls. We envisioned that to happen through at least the first half of 2019, we will say that again. We still think it's going to happen through at least the first half of 2019.

James Schneider

Analyst, Goldman Sachs & Co. LLC

Q

That's helpful. Thank you. And then maybe turning to the corporate payments space for a minute. Clearly, continued strength in the results there. But one of the things that we've seen from some of your competitors is the acquisition outright of [ph] our (00:52:11) portfolios for the accounts payable and accounts receivable type management software where you've chosen to rely explicitly on a partner strategy. Can you maybe talk about your appetite for potential additional M&A specifically to have your own software solution in the future?

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

A

So we have – if you look at our software now, when we bought AOC, the combination of AOC and what we had prior to that and then [indiscernible] (00:52:43) what was sitting in the EFS, we actually feel pretty good about the underlying product capability. And we like the fact that we built it using micro services, cloud-based. And we just keep adding to the stack that we have. And so when we think about acquisitions, I think about it two different ways. I think about them in that space as technology plays. And for us, that becomes a build versus buy analysis. And we look at that to say are there certain things we need to do in order to build out the product? But we like the ability to build on what we've got. And then on the more vertical side of that, that's something we will continue to play in the marketplace. And we'll be interested if someone has a piece of a product or a piece of what they're doing that we think is unique that comes with a book of business, then we'll continue to be interested in that as well.

So we look at both of those things, and pretty thoughtfully. But we also feel pretty good about what we can build upon based on what we've already acquired and put together so far.

James Schneider

Analyst, Goldman Sachs & Co. LLC

Great. And then maybe just one clarification, if I could. Clearly, there's some dilution on both the new portfolios as well as the acquisitions in the beginning of the year. As you exit Q4 of 2019, will you expect operating margins to be up, flat, or down on a year-over-year basis?

Roberto Simon

Chief Financial Officer, WEX, Inc.

So let me tell you, I mean, specifically to those portfolios. So obviously, when you look at 2019, as we said, we expect to be dilutive on the first half. And then on the second half we're going to be – we expect to be like fully ramped. So what you should expect for 2020 is, obviously, the full year portfolio fully converted. And obviously, when you look 2019 through 2020, your margin should be better than 2019 because you will have the two full halves with the revenue and the cost base aligned.

James Schneider

Analyst, Goldman Sachs & Co. LLC

Thank you.

Operator: Our next question comes from the line of Sanjay Sakhrani from KBW. Your line is open.

[indiscernible] (00:55:03) for Sanjay. Thanks for taking my question. I guess, first I had a quick question on the Travel business. It seemed like you guys announced some good wins there, including the Etraveli portfolio. How should we think about the potential opportunity there? And when does that start to ramp in?

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

Sure. It's starting to ramp now, and so it'll ramp throughout the year. And you talked more broadly about what we expect to see in the corporate payments business. I would restate what Roberto said. We expect it to be in line with our 10% to 15% guidance range, our long-term guidance range in the course of this year. And the acquisitions are going to push it on top of that, but the organic growth rate we expect to be between 10% to 15%. And then, when you aggregate that with acquisitions, [indiscernible] (00:55:56) being over 30%.

Thanks for that. And I guess, a quick clarification on the Shell and Chevron portfolios. You've had quite a bit of discussion on that already, but I guess once you're past the upfront expenses, how should we think about the profitability of these portfolios versus the rest of the Fleet business?

Roberto Simon

Chief Financial Officer, WEX, Inc.

So I will answer the question for you. I mean, this is once we have those fully portfolios ramped on a run-rate basis, the profitability of those two portfolios is going to be very similar to any of the other oil companies that we operate. You know that within the Fleet business, we have the over-the-road, on the trucking industry side. And then, when you get more on the Fleet North America side, you have a small fleet, you have a larger fleet. When you compare those portfolios within the oil companies, their profitability is going to be very similar to the other oil companies that we run.

Q

Got it. And if I can squeeze in a last one on Discovery Benefits. I know it's not contributing to earnings this year. But, I guess, going forward, how should we think about the accretion expectation on an earnings basis?

A

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

So what we've said about DBI, we've talked about it being immaterial from an EPS perspective this year. We obviously think it's going to continue to grow. We talked about it that combined with their Healthcare business, we think it will continue to be a high-teens grower and it will continue to scale.

We also talked about the fact that we expect to see \$20 million worth of synergies that we're going to get over time. So if you cumulate all of those things, we do expect it to look more like a margin profile of the rest of their Healthcare business.

Q

Got it. Thank you very much.

Operator: Our next question comes from the line of Oscar Turner from SunTrust. Your line is open.

Oscar Turner

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hey, guys. Good afternoon. First question is just on Fleet. I was wondering, did you guys provide the expected revenue contribution from Shell and Chevron this year? Apologies if I missed that. And just to clarify, it sounds like we shouldn't expect to see a material revenue contribution until the second half of 2019?

Roberto Simon

Chief Financial Officer, WEX, Inc.

A

So this is Roberto. You know we don't disclose revenue or profitability by customer or portfolio, but – and Melissa has just mentioned a while ago, we give direction on the number of gallons that those two portfolios will add to our business. And if you take these gallons and you translate them into revenue, you will have approximately \$60 million to \$70 million in revenue on a full-year basis. So this will give you an idea, obviously, on whether we should be in 2021 now those two portfolios are fully ramped and, obviously, considering the fuel prices that we have today.

Oscar Turner

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Thanks. And then...

Operator: Our next question comes from the line of Matt O'Neill from Autonomous Research. Your line is open.

Matthew O'Neill

Analyst, Autonomous Research

Q

Yeah, hi. Thanks, guys, for taking my question. Actually, almost all of them have been basically asked and answered. But, I guess, if I could try to ask on the sort of Travel and Corporate momentum we saw in the fourth quarter in another way, maybe what would you characterize, if anything, as not being necessarily repeatable, if we wanted to think about that kind of levels going forward versus maybe not.

Melissa D. Smith

President, Chief Executive Officer & Director, WEX, Inc.

A

One of the things that Roberto talked about in his section was around the idea that we had, the rates were elevated, that some of our discount rates and the interchange was a little bit higher in the fourth quarter. So – and he talked about the way he's running that. So that's something that – it's something we didn't expect will repeat throughout the course of this year. In terms of spend volume, some of what we will experience depends on what's going to happen overall in the Travel marketplace, because that's still a significant part of the portfolio.

So while we continue to bring on new business, how our existing partners perform has a pretty big impact [ph] on what happens to their growth in spend volume (01:00:49). And Roberto talked about expecting that to be mid-teens to high-teens. And, of course, in 2019 just to kind of give you an indicator, so the rate we expect it to be a little bit different than what you've seen in Q4. But from a spend volume perspective, we expect to continue to see volume coming through that will be driven based on existing customers and the performance of those portfolios, but also adding in new portfolios.

You also saw – if you're looking at growth rates year-over-year, just keep in mind that we get the benefit of revs in 2018 compared to 2017. So it's a little bit of [ph] lift (01:01:34) in terms of revenue.

Matthew O'Neill

Analyst, Autonomous Research

Q

Got it. Thank you for that. And then I guess just sort of follow on that and specific to the interchange in that segment, trying to think about kind of the overall bias going forward sort of higher or lower, I think, I'm going to guess that it's probably complex or maybe the organic business or the business prior to Noventis is maybe stable. But then with Noventis, it will weigh the average higher as that volume gets internalized? Am I thinking about that conceptually correctly?

Roberto Simon

Chief Financial Officer, WEX, Inc.

A

Yeah, let me put this in context for you. So as I said that during the call. We expect for 2019 approximately 10 basis points on the net interchange higher than on the average of 2018. And there are a couple of reasons. Number one, obviously, the acquisition of Noventis is going to add a few points to our interchange rate. The second thing, as I said, with one of our OTAs, we amended the contract. There's no impact to total revenue. What we are doing you will see during the year a reclassification from other revenue into payment processing revenue. And the way we calculate the net interchange is based on the processing revenue. So that's kind of the reason why you're going to see the rate to go up. And then the final thing that you always see as a more difficult now to

manage is both the customer spend mix, as well as from where the spend comes between domestic and international.

Matthew O'Neill

Analyst, Autonomous Research



Okay. Got it. Thank you very much for that clarification. Appreciate it.

Operator: If there are no more questions over the phone, presenters, you may continue.

Steven Alan Elder

Senior Vice President, Global Investor Relations, WEX, Inc.

Sorry. I couldn't hear you, operator, but I think that's all the time we have for tonight. And we'll look forward to speaking with everyone next quarter. Thank you.

Operator: This concludes today's conference call. Thank you for joining. Have a wonderful day. You may all disconnect.

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