FinTech

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2020 Outlook: Bill.com IPO Could Serve as Catalyst for B2B Payments Consolidation, While Banks Likely to Add FinTech Pizzazz Through M&A

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WHAT YOU SHOULD KNOW: While 2019 is likely to be remembered by investors in the FinTech space as the year in which three huge M&A transactions converted six payment giants into three, we believe 2020 is likely to see a continuation of the consolidation trend but with a higher volume of smaller deals rather than a few very large ones. Some of the acquirers in those deals are likely to be banks, whose combination of FinTech capabilities with their scale, distribution capabilities and large balance sheets will enable them to take advantage of digital trends rather than becoming disintermediated by them, in our view. And amidst a rapidly evolving market, a few firms unable to adapt to rising competition will find their once-differentiated offerings have become less so, with the upshot being diminished standings and shrinking market capitalizations. Among our thoughts as the 2020 trading year kicks off are the following:

- To some extent, the impact of the 2019 payments megadeals – Fiserv's (FISV, Not Rated) merger with First Data, FIS's (FIS, Not Rated) merger with Worldpay, and Global Payments' (GPN, Not Rated) merger with TSYS – has yet to play out. Some of the management teams within our FinTech coverage universe, including those of i3 Verticals (IIIV, Buy, $31 PT) and ACI Worldwide (ACIW, Buy, $40 PT), have stated that while the payment giants are inward-looking in the coming quarters, focusing on integrating their firms and delivering on projected synergies, they will have an opportunity to land business that might otherwise have gone to one of those larger firms. Meanwhile, FISV in particular has been clear that with First Data's Clover and Clover Go point-of-sale (POS) offerings now backed by deeper pockets and a broad bank distribution network that it intends to take concentrated aim at Square (SQ, Sell, $30 PT) in the battle for the business of medium-sized merchants.
- We believe 2020 was already shaping up to be a year in which consolidation would take place in the B2B payments space, especially given its high level of fragmentation and the array of firms with assets that could be more efficiently leveraged as part of a larger entity. However, we think the successful initial public offering of Bill.com (BILL, Not Rated), which appreciated by more than 60% on its first day of trading on December 12, may serve as an accelerant to this trend. The IPO of the provider of cloud-based billing solutions helped to highlight what Mastercard (MA, Not Rated) has estimated as a $100tn opportunity in the accounts payable area of B2B payments while providing a boost to the valuations of other firms in the space.
- One way in which investors can play this trend is through two stocks within our coverage universe – FleetCor (FLT, Buy, $340 PT) and WEX (WEX, Buy, $255 PT) – that are already well entrenched within the B2B payments space and seeking to become more so through M&A as they diversify their business models away from fleet fuel cards exposed to fuel price volatility. We anticipate more deals along the lines of FLT's acquisition in April 2019 of Nvoicepay, which added automated accounts payable transactions to its card payment processing capabilities, with the additional diversification helping to support the valuations of both FLT and WEX. We note that both firms have ample dry powder to execute on M&A during the months ahead, with FLT and WEX having over $5bn and $1.2bn, respectively, in cash and revolver availability.

- If our 2020 thesis proves out, then many of the B2B firms that will be targeted by larger firms like FLT and WEX will be smaller and venture capital-backed, and in many cases finally reaching the point at which accepting a bid would make sense after fueling their growth through multiple rounds of venture funding.

- At the same time, we believe some of the publicly traded firms within our coverage universe could attract larger suitors attracted to their growth trajectories and critical mass within particular verticals, with B2B payments representing one of these. Included in our list of potential take-out candidates are ACIW, IIIV and Repay Holdings (RPAY, Buy, $16 PT). Payments is a scale business by nature; having a larger foundation across which to spread fixed costs is a key to sustained success in the space, as ACIW demonstrated last year in quadrupling the adjusted EBITDA margins of its On Demand segment through the acquisition of Speedpay from Western Union (WU, Buy, $31 PT). In the cases of IIIV and RPAY, the likely rationale for a takeout by a larger firm would be access to underpenetrated verticals such as public sector and education with the former and personal loan and auto loan payments with the latter.

- We have also identified Verra Mobility's (VRRM, Buy, $18 PT) cashless tolling payment footprint in the U.S. and nascent presence in Europe as potentially attractive to FLT, which participates in the cashless tolling payment space in Brazil and has a similar profile in terms of adjusted EBITDA margins in the mid-50s and recurring revenue in the 90s. Like IIIV, we view VRRM as a good name to own during an economic downturn inasmuch as the verticals in which it operates should be relatively shielded from the impact of an economic downturn. We have also pointed to Q2 Holdings' (QTWO, Buy, $95 PT) strengthening competitive position, which has been enhanced by the expansion of its product offering, as making it more of a threat to larger competitors Jack Henry (JKHY, Not Rated), FISV and FIS. As such, we believe it is increasingly likely that QTWO will become a takeover target of one of its larger competitors.

- During the past few years one of the notions that has arisen among investors in the Fintech space has been that the losers amidst the advent of financial technology are traditional banks that possess advantages in scale and distribution but are weighed down by their "bricks and mortar" physical presence and significant regulatory oversight. While we believe there has been some truth to this idea, we have already seen several banks that have enhanced their FinTech presence via M&A, and we expect this theme to continue to play out in 2020. We view the actions taken by U.S. Bancorp (USB, Not Rated) through its subsidiary Elavon during 2H19 as likely presaging the moves of its bank peers going forward, as USB bought Talech, a cloud-based POS provider that positioned it to take business from SQ, and then in November it acquired Sage Pay, a payments gateway business in the U.K. and Ireland., enhancing its e-commerce capabilities.

- While the FinTech industry is evolving rapidly, that evolution has not been even across the space. One area in which both innovation and inertia are on display is money transfer, as online remittance firms have continued to grow, albeit not at the expense of long-time incumbent WU and niche player Intermex (IMXI, Buy, $20 PT). While some traders have speculated for years that WU would crumble in the face of emerging online competition, the company's operating performance has been remarkably resilient. We attribute the stability of WU's core business to the fact that its money-transfer kiosks around the world do not require that their customers have a bank account – as many of the alternatives identified as threats to its performance do – when many of them fall into the category of "unbanked." That factor is particularly potent when combined with WU's status as a trusted brand around the world. IMXI, which offers traditional money transfers from bodegas and the like, operates below the radar screens of the online players by serving the unbanked in various U.S. states.

- We see no signs that the core remittance businesses of WU and IMXI will suddenly begin to deteriorate even as we anticipate the continued rapid expansion of the VC-funded online firms in the space, several of which commanded high-teens revenue multiples in their latest funding rounds. The primary reason why these two views are not contradictory is the simple fact that more than 50% of the global money transfer industry is still controlled by banks, which is the group from which the online firms have been taking market share, while the kiosks and bodegas through which WU and IMXI serve the underbanked have been largely unaffected by the rise of the digital players. At the same time, we believe WU's digital offering, which management expects to generate revenue growth in the 20% context over the next three years, is underappreciated. At a time when online money transfer firms such as TransferWise (Private), Azimo (Private), WorldRemit (Private) and Remitly (Private) have commanded valuations implying multiples of revenues in the high-teens, we think WU.com's much more significant scale versus its online peers, and its newly pursued opportunities to bring its capabilities to banks around the world through white-label programs, merits more acknowledgement from the market.

- We view as less well positioned to stave off increasing competition firms such as SQ and Green Dot Corporation (GDOT, Neutral) whose offerings look less differentiated and more commoditized. We believe SQ's premium valuation is increasingly difficult to justify as its core payment processing offering is essentially a commodity – the company's changes to its payments pricing in September were a demonstration of this reality, in our view – with VC-funded SQ clones offering similar POS solutions, and the ancillary offerings that fill out the rest of its "ecosystem" looking less special amidst so many other firms offering back-office outsourcing solutions. As for Square Capital, we continue to believe that while the loans it originated may boost SQ's results in the near term while reducing churn among its core payment customers, growth in lending will make the company increasingly dependent on credit as a means of driving its growth and therefore increasingly at risk when credit-market volatility arises. As such, we view the expansion of Square Capital as a negative for the company's risk profile that is not reflected in SQ's lofty multiple, and we would regard any announcement that SQ has succeeded in gaining approval for an industrial loan charter (ILC) as a negative catalyst.

- GDOT shares were significant underperformers during 2019 due to a couple of downward guidance revisions, CEO Steve Streit's acknowledgement that "neobanks" with sizeable marketing budgets funded by their VC sponsors had negatively impacted demand for the company's core prepaid debit card offering, and the resignations of Streit and CFO Mark Shifke announced last month. While GDOT shares trade at very low multiples that could tempt investors to take a flyer on the stock, our view that the future of the prepaid cards at the core of the company's business is now in question given the proliferation of alternatives dampens our enthusiasm for the stock even as a speculative play.

BTIG Covered Companies Mentioned in this Report

I3 VERTICALS, INC. (IIIV, Buy, $31.00 PT; Current Price: $28.30; Analyst: Mark.Palmer)
ACI WORLDWIDE INC. (ACIW, Buy, $40.00 PT; Current Price: $37.72; Analyst: Mark.Palmer)
SQUARE INC. (SQ, Sell, $30.00 PT; Current Price: $63.80; Analyst: Mark.Palmer)
FLEETCOR TECHNOLOGIES, INC. (FLT, Buy, $340.00 PT; Current Price: $285.82; Analyst: Mark.Palmer)
WEX INC. (WEX, Buy, $255.00 PT; Current Price: $209.43; Analyst: Mark.Palmer)
REPAY HOLDINGS CORP (RPAY, Buy, $16.00 PT; Current Price: $14.58; Analyst: Mark.Palmer)
WESTERN UNION COMPANY (WU, Buy, $31.00 PT; Current Price: $27.37; Analyst: Mark.Palmer)
VERRA MOBILITY CORP (VRRM, Buy, $18.00 PT; Current Price: $14.04; Analyst: Mark.Palmer)
Q2 HOLDINGS (QTWO, Buy, $95.00 PT; Current Price: $82.44; Analyst: Mark.Palmer)
INTERNATIONAL MONEY EXPRESS, INC. (IMXI, Buy, $20.00 PT; Current Price: $11.99; Analyst: Mark.Palmer)
GREEN DOT CORPORATION (GDOT, Neutral, $N/A PT; Current Price: $23.23; Analyst: Mark.Palmer)

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