Verra Mobility Corporation (VRRM)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

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<tbody>
<tr>
<td>52WK H-L ($) :</td>
<td>17 - 6</td>
<td>Suitability:</td>
<td>11</td>
<td>Q1</td>
<td>0.13A</td>
<td>0.15A</td>
<td>0.20E</td>
</tr>
<tr>
<td>Market Cap (mil):</td>
<td>1,572</td>
<td>Price Target ($) :</td>
<td>12</td>
<td>Q2</td>
<td>0.16A</td>
<td>0.07E</td>
<td>0.15E</td>
</tr>
<tr>
<td>Shares Out (mil):</td>
<td>163.9</td>
<td>L-Term Rev. Gr Rate Est:</td>
<td>10%</td>
<td>Q3</td>
<td>0.22A</td>
<td>0.17E</td>
<td>0.18E</td>
</tr>
<tr>
<td>Float (mil):</td>
<td>129.6</td>
<td>L-Term EPS Gr Rate Est:</td>
<td>100.0%</td>
<td>Q4</td>
<td>0.17A</td>
<td>0.15E</td>
<td>0.16E</td>
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<tr>
<td>Avg. Daily Vol (mil):</td>
<td>2.04</td>
<td>Debt/Cap:</td>
<td>0.1%</td>
<td>Total</td>
<td>0.68A</td>
<td>0.54E</td>
<td>0.68E</td>
</tr>
<tr>
<td>Dividend ($) :</td>
<td>0.00</td>
<td>ROE:</td>
<td></td>
<td>FY P/E</td>
<td>14.1x</td>
<td>17.8x</td>
<td>14.1x</td>
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<tr>
<td>Yield (%):</td>
<td>0.0</td>
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Company Description

Verra Mobility is a leading provider of smart mobility technology solutions and services throughout the US, Canada and Europe. VRRM serves the world’s largest rental companies and commercial fleets in managing tolling payments and violations. Verra operates with two segments, Commercial Services (~62% of 2019 revenue) and Government Solutions (~38% of 2019 revenue). Verra manages more than 6 million vehicles for the largest rental car and fleet management companies and operates ~4,500 red-light, speed and school bus stop arm cameras.

Revenue Profile

Commercial Services (~52% of Q1-20 revenue): Verra helps rental car companies (“RACs”) and fleet management companies (“FMCs”) manage their toll payments, process vehicle violations, and manage the vehicle title/registration process.

■ Toll Management Solutions (~80-85% of segment revenue): Verra helps RACs and FMCs manage their toll payments. Verra is paid a revenue share from the ~$4 daily administration fee plus the difference between the toll authority cash rate (what Verra charges customers) and the discounted electronic rate (what Verra pays the toll authorities). We estimate Verra earns ~$0.90-1.00 per processed toll.

■ Violations Management Solutions (~10-15% of segment revenue): Verra helps RACs and FMCs process driving violations incurred by their drivers. A little over half of this unit is the US operations and a little less than half is the European operation (EPC acquisition). Verra charges a processing/service fee for each processed violation and we estimate they earn ~$6-7 per processed violation.

■ Title and Registration Solutions (~5% of segment revenue): Verra receives a transaction fee for each title/registration/renewal. Verra can earn additional fees from data management or from other services (rental car stickers, state transfers, title transfers, international registration plan for trucks, and corrections).

Government Solutions (~48% of Q1-20 revenue): Verra serves as a partner to local government agencies by providing road safety cameras (red-light, speed and school bus stop arm cameras) that promote traffic safety and reduce traffic violations.

■ Service Revenue (69% of Q1-20 revenue): Operating and maintaining safety enforcement systems. Revenue is recognized when citations are issued or paid.

■ Red light camera: We estimate the initial cost of a camera is ~$60k and they will generate revenue of ~$42k/year (~$3.5k/month).

■ Speed camera: We estimate the initial cost of a camera is ~$60k and they will generate revenue of ~$46k/year (~3.8-4.0k/month).

■ School bus camera: We estimate the initial cost of a camera is ~$8.5k and they will generate revenue of ~5.5k/year (~$0.4-0.5k/month).

■ Product sales Revenue (31% of Q1-20 revenue): Generated by the sale of photo enforcement equipment to certain government solutions customers (small number of customers who purchase this equipment). This revenue is recognized when equipment is accepted or installed. This revenue stream can be volatile depending on the number of cameras purchased, and could be well above/below 3% of segment revenue.
Verra Mobility Corporation
May 18, 2020

Competition
Commercial Services: Verra has ~95% of tolling authorities and relationships with ~95% of rental car companies (including the top 3).
- Tolling authorities: In 2015, tolling authorities collected over $13.8 billion in toll revenues with drivers taking 5.7+ billion trips on US tolled roads. The industry remains highly fragmented and complex with 50+ tolling authorities each operating as independent organizations with specific coverage region and technology platforms.
- US rental car industry: Estimated to be ~$30 billion in revenue and is highly consolidated with the top 3 companies (Enterprise, Hertz, and Avis Budget) comprising a majority of revenue.
- US fleet industry: The Automotive Fleet Magazine estimates there is ~6.4 million fleet vehicles in the US with ~3 million under management by fleet management companies.
- European rental car/fleet management industry: The European rental car company market is more fragmented than the US, though remains large in size. There are an estimated 6+ million vehicles in Europe, with over half under management by the top 5 European fleet management companies.

Government Solutions:
- Market share: Verra notes they are the market leader in automated safety solutions, with ~46% market share in red light cameras, ~55% in speed cameras, ~48% in school bus road safety cameras, and have won ~41% of RFPs since 2018.
- Competitors: Verra faces some competition in automated safety solutions from other red light, school bus and speed photo enforcement vendors (i.e. Conduent and Redflex). They also face competition from both their own customers as they may choose to invest in their own internal solutions and new technologies.

Quick Summary
- Q1 results were solid given environment.
  - Adjusted EPS of $0.15, beat consensus $0.13 (we were $0.10). Variance to our estimate due to revenue (+$0.05), margins ($0.01), offset by tax (-$0.01).
  - Revenue of $117 million was ~14% above consensus $102 million (we were $93 million). We estimate organic constant-fx growth was +18% yoy (~18% yoy growth in Q4).
  - Adjusted EBITDA Margins of 47.0%; down ~510bps yoy (we estimated 45.7%).
  - Net Leverage 3.1X TTM (3.2X last quarter).

Segment Results from Q1
- Commercial Services (~52% of revs)
  - Revenue of $61.2 million was above our $42.5 million estimate; -4% yoy organic growth (+16% in Q4). We estimate Pagatelia added ~$1 million to revenue.
  - EBITDA Margins of 54.9% (we estimated 56.4%)
- Government Solutions (~48% of revenues)
  - Revenue of $55.5 million was above our $50.7 million estimate; +55% yoy growth (+21% yoy in Q4).
  - EBITDA Margins of 38.3% (we estimated 36.8%)

2020 guidance was withdrawn in March; however, management provided some trends through April on the Q1 call.
- Commercial: Revenue down 64% yoy.
- Government: Revenue grew 49% yoy; Service revenue was flatish yoy (growth in speed offset by losses in red light program/crossing guard); Product revenue continued to be strong (installed 72 cameras so far in Q2).
- Interesting commentary from the Q1 call:
  - Cost saving initiatives - In response to coronavirus they have implemented a number of cost saving initiatives including: Eliminating non-essential travel and discretionary spending, hiring freeze on non-essential employees, furloughing ~30% of employees, CEO forgoing Q2 salary, other salary cuts and BOD compensation reduced.
  - Renewals/New Win - During Q1, renewed two large photo enforcement programs with the city of Chicago and Washington DC and announced new speed program for Morningside, Maryland schools.
  - Georgia - Implementation began for ~40 speed cameras at two Georgia schools

Our $11 price target reflects a P/E multiple of ~16X our prospective NTM EPS a year out from now of $0.70 (using 12 months ending 6/30/22), which reflects a ~20% discount to the S&P NTM P/E (below the 2019 low of 9% discount). We think the company remains a good asset and an attractive potential take-out, but it is in an uncertain time, and leverage could rise back to ~4X as EBITDA falls which warrants a lower than typical multiple.
Investment Thesis

Clear market leader across both segments. The network of all the largest car rental companies and 95% of the US toll roads provides a massive moat. Similarly, a ~50% share of red light, speed, and school bus cameras provides a strong position.

Small fee in context of rental. The tolling fees likely average about 1% of total vehicle rental industry revenue, small enough to not create significant consumer pushback, particularly when it saves time (can go through electronic lanes) and avoid cash payments.

Rental car tolling is expected to exhibit solid growth. Management's long-term guidance of 6-8% organic revenue growth is driven by tolling tailwinds such as increased cashless tolling, number of toll ways, and congestion pricing. Fleet management companies' vehicle enrollment has been growing mid single digits as well.

Government safety/violation cameras could grow well for years. Management's long-term guidance of 2-4% organic revenue growth net of attrition is driven by 50% win rate on RFPs, new legislation, increased focus on school zones/school bus stops, and strong cash flow from red light cameras.

Strong franchise that could be attractive asset for many other payment companies. Recurring revenue is ~98% and the company has a highly defensible business model. Long-term relationships with the tolling/issuing authorities is a significant competitive advantage that helps maintain their existing partner and customer contracts.

Risks & Caveats

Partner concentration. Revenue from the top Commercial Services partner was 18.7% of total revenue in 2019. Two other partners accounted for 14.5% and 13.5% of total revenue. These customers were part of the HTA acquisition.

Client concentration. NYC accounted for 14.6% of revenue in 2019 (Government Solutions customer).

Rental car company contracts. Revenue generated from with rental car companies is typically based on long-term contracts with a margin-share model. Changes from a per rental day fee to per toll usage day fee structure could have a material impact on revenue.

Government legislation. ~38% of revenue comes from the Government Solutions segment. Any changes in legislation related to photo enforcement of red light, school bus, speed limit, and bus lane laws could have a material impact to revenue.

Government financed projects. Projects in the Government Solutions segment are often multi-year projects funded through appropriated funds. These projects can be terminated at any point due to lack of funding or changes in government/political developments.

New products and geographies. Verra has started to develop new products (Peasy) and enter new geographies (Europe) they have not previous been in. New products and geographies could be impacted by customer demand and increased competition.

Third-party relationships. Verra relies on several third-party providers (such as National Law Enforcement Telecommunications System, Polk, DMVDesk, CVR, and Dealertrack) to provide direct connections to state DMVs. The Government Solutions segment also relies on third-party manufacturers for work such as camera manufacturing, automated license plate recognition provider, and other outsourced work.

Acquisition integration. Verra recently acquired HTA and EPC and future acquisitions may have integration risks or other unanticipated risks.

Equity ownership concentration. Platinum Equity owned ~16% of class A stock at the end of 2019. The large voting power could influence the outcome of corporate actions requiring shareholder approval. Platinum Equity also has the right to nominate up to 3 Board directors.
## Verra Mobility Corporation

May 18, 2020

### Supplemental Information

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<tr>
<th></th>
<th>Q1-19</th>
<th>Q2-19</th>
<th>Q3-19</th>
<th>Q4-19</th>
<th>Q1-20</th>
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<tr>
<td>Commercial Services</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>($ millions)</td>
<td>62.6</td>
<td>68.1</td>
<td>77.6</td>
<td>68.2</td>
<td>61.2</td>
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<tr>
<td>YoY Growth</td>
<td>22%</td>
<td>14%</td>
<td>8%</td>
<td>17%</td>
<td>-2%</td>
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<tr>
<td>Government Solutions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>($ millions)</td>
<td>35.9</td>
<td>41.5</td>
<td>50.6</td>
<td>44.3</td>
<td>55.5</td>
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<tr>
<td>YoY Growth</td>
<td>-3%</td>
<td>8%</td>
<td>42%</td>
<td>21%</td>
<td>55%</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>98.5</strong></td>
<td><strong>109.6</strong></td>
<td><strong>128.2</strong></td>
<td><strong>112.5</strong></td>
<td><strong>116.7</strong></td>
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<tr>
<td>YoY Growth</td>
<td>12%</td>
<td>12%</td>
<td>19%</td>
<td>18%</td>
<td>18%</td>
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<tr>
<td><strong>EBITDA ($ millions)</strong></td>
<td><strong>51.3</strong></td>
<td><strong>59.7</strong></td>
<td><strong>70.8</strong></td>
<td><strong>59.6</strong></td>
<td><strong>54.6</strong></td>
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<tr>
<td>EBITDA margin</td>
<td>52.1%</td>
<td>54.5%</td>
<td>55.2%</td>
<td>53.0%</td>
<td>46.8%</td>
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### Customer Concentration

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<tr>
<th>Customer</th>
<th>2019 YoY Growth</th>
<th>2020 YoY Growth</th>
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<tr>
<td>Hertz</td>
<td>18.1</td>
<td>18.3</td>
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<tr>
<td>Avis</td>
<td>N/A</td>
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<tr>
<td>Enterprise</td>
<td>13.8</td>
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<tr>
<td>Other Commercial</td>
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<td>NYC</td>
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<tr>
<td>Other Government</td>
<td>N/A</td>
<td>25.7</td>
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*Source: Company Reports and Baird Estimates*
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