Verra Mobility
Q3 2024 Earnings Call

Verra Mobility Q3 2024 Prepared Remarks

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THIRD QUARTER 2024 EARNINGS CALL

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Mark Zindler, Vice President, Investor Relations

Thank you. Good afternoon and welcome to Verra Mobility's third-quarter 2024 earnings call. Today, we'll be discussing the results announced in our press release issued after the market close along with our earnings presentation which is available on the Investor Relations section of our website at ir.verramobility.com. With me on the call are David Roberts, Verra Mobility's Chief Executive Officer, and Craig Conti, our Chief Financial Officer. David will begin with prepared remarks, followed by Craig, and then we'll open up the call for Q&A.

Management may make forward-looking statements during the call regarding future events, anticipated future trends and the anticipated future performance of the company. We caution you that such statements are not guarantees of future performance and involve risks and uncertainties that are difficult to predict.

Actual results may differ materially from those projected in the forward-looking statements due to a variety of risk factors. These factors are described in our SEC filings. Please refer to our earnings press release and investor presentation for Verra Mobility's complete forward-looking statement disclosure. Any forward-looking statements that we make on this call are based on our beliefs and assumptions today, and we do not undertake any obligation to update forward-looking statements.

Finally, during today's call, we'll refer to certain non-GAAP financial measures. A reconciliation of these non-GAAP measures to the most directly comparable GAAP measure is included in our earnings release, quarterly earnings presentation and investor presentation, all of which can be found on our website at ir.verramobility.com.

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

David Roberts, CEO, Verra Mobility

Thank you, Mark and thanks everyone for joining us.

Before I start, I want to offer our condolences for all those who have been impacted from hurricanes Helene and Milton. We hope for a continued recovery and that everyone impacted can get back to their normal way of life as soon as possible.

Starting with our consolidated financial results, we had a solid third quarter, with revenue, Adjusted EBITDA, and Adjusted EPS directly in-line with our internal expectations.

Consolidated revenue growth was 7 percent, adjusted EBITDA increased 8 percent and adjusted EPS increased 10 percent over the prior year period, demonstrating what we view as the predictable strength of our portfolio of businesses. Based on our year-to-date financial performance and our outlook for the remainder of the year, we are reaffirming full year 2024 revenue, adjusted EBITDA and adjusted EPS guidance while increasing the Adjusted Free Cash Flow guide to the upper-end of the range. Craig will elaborate on the details in his remarks.

Today, we'll highlight four value drivers underpinning our businesses: 1) The current sentiment from the major airlines continues to suggest resilient travel demand; albeit, off the first half 2024 highs; 2) The demand for automated photo enforcement is strong and growing; 3) the company continues to generate robust free cash flow, providing optionality for capital allocation; and, 4) we are putting measures in place to stabilize the T2 parking business and rejuvenate it's growth trajectory.

Starting with travel demand, year-to-date TSA passenger volumes as of September 30th stood at about 106 percent of 2023 volume for the same period, driven by strong consumer and business demand. However, travel has decelerated in September and October, particularly in the last week of September and the second week of October due to Hurricanes Helene and Milton. We have seen a recent re-acceleration of travel back to the levels assumed in our guidance, so we feel comfortable about travel volumes as we close out the year. Additionally, the current sentiment from the major airlines along with the independent surveys we have reviewed indicates resilient demand, suggesting TSA volume growth commensurate with GDP-type growth next year.

These domestic travel trends had a strong impact on our Commercial Services business. We delivered outstanding results driven by strong performance in RAC tolling and our continued solid performance in the fleet management business. Third quarter revenue of $109 million grew 11 percent over the prior year quarter and segment profit margins of 67 percent were up about 30 basis points over the last year period due primarily to the strength in RAC tolling.

The third quarter travel demand drove solid growth in adopted rental agreements and tolls incurred, all of which resulted in a 6 percent increase in RAC tolling revenue. Additionally, our FMC business generated revenue of $18 million for the quarter, representing 9 percent growth over the prior year period, primarily driven by enrollment of new vehicles and increased tolling from FMC customers.

Moving on to Government Solutions, service revenue - which reflects 95 percent of total revenue for the quarter and is primarily recurring revenue - grew 7 percent over the same period last year. The service revenue growth was driven by program expansion from existing customers and new cites implementing photo enforcement efforts to improve road safety. To this point, outside of New York City, we drove 12 percent service revenue growth due to these factors. Total revenue, including international product sales were up about 6 percent over the prior year quarter.

Looking at the big picture, the demand for automated photo enforcement has never been stronger. We generated a strong third quarter in contract awards and saw additional legislative actions supporting automated enforcement. In the third quarter, we won contract awards representing about $22 million of incremental annual recurring revenue at full run-rate, bringing the Year-to-Date incremental ARR total to $45 million. The largest award came through our partnership with Hayden AI supporting automated bus lane and bus stop enforcement, with our share representing approximately $8 million of incremental ARR. Our partnership with

Hayden AI demonstrates the new and expanding opportunities for automated enforcement beyond speed and red-light enforcement.

Additionally, we were awarded contracts in Florida representing about $3 million of incremental ARR and in Washington State, which represented about $2 million in incremental ARR.

Other notable awards include speed enforcement programs in Australia and Canada, which combined, represent about $5 million in total incremental ARR.

As we shared in a press release earlier this month, I'm excited to report that the San Francisco Municipal Transportation Agency awarded us the contract to manage its speed safety program. This is California's first automated speed safety program under the state's legislative authorization. Under this contract, we will design, build, operate and maintain a speed safety program with cameras at 33 sites across San Francisco. The goal is to have a fully operational program in early 2025. Additionally, we anticipate competing for the other California cities' speed enforcement pilot programs over the next year. These pilot programs are a pivotal step in what we expect will be a broader initiative to expand speed safety across the state, as more citizens demand solutions from lawmakers to help make roads safer in California.

Moving on to New York City, we look forward to submitting our proposal for the automated traffic enforcement program. New York City is the leader in using automated enforcement technology to make roads safer and more efficient, and they have trusted us to be their technology partner for a highly complex program many years. While the program is subject to a very competitive procurement process, we remain confident that our scope of services and support meet the specifications for the program today and we remain ready to meet the City's evolving needs quickly should we be afforded the ongoing opportunity. We're also excited that New York's red-light expansion bill was signed into law earlier last week, allowing for the expansion of cameras at 450 additional intersections in the city of New York. This is an important milestone in the goals and objectives of Vision Zero.

Next, a brief update on T2 Systems…we generated total revenue of approximately $21 million for the third quarter, slightly below our internal expectations. Segment profit was $4 million for the quarter with segment profit dollars and margins growing sequentially over the second quarter as we anticipated.

In August, we announced that Lin Bo joined our executive leadership team to lead T2, bringing valuable experience in enhancing operations, driving growth and leading business transformation efforts.

As a reminder, our strategic thesis around T2 revolved around the strong and durable recurring revenue of permits and enforcement for cities and universities. We expect this demand to increase over time with the unique challenges related to urbanization and curb management. To date, we have encountered several challenges since we closed the acquisition in December

2021. First, the parking industry has experienced a transition away from hardware and related services, which historically represented about 45 percent of revenue, to focus on software and mobile payment solutions. This is expected to benefit our business in the long-term but has impacted short-term revenue growth and margins. Additionally, we expect to see a greater conversion of our SaaS pipeline to backlog and revenue generation, and Lin is earnestly working on re-tooling the organization to drive execution in this area. The market opportunity for T2 is significant, and we're taking the steps needed to drive long-term execution and performance.

We also added another talented and experienced executive to our leadership team. We appointed Harshad Kharche as Senior Vice President of Business Transformation. In this role, Harshad will ensure continued adoption of Verra Mobility's business operating system and help enhance our culture of continuous improvement company-wide.

Next, we reported a record-quarter of free cash flow, generating $85 million for the third quarter. This provides significant optionality for capital deployment. We have been actively evaluating M&A opportunities in current and adjacent technology sectors and we also have approximately $50 million remaining under our existing share buyback authorization.

Next, our long-term outlook remains intact relative to the Revenue and Adjusted EBITDA targets we provided at our July 2022 Investor Day. As we've indicated, there will be years where we exceed the growth rates and other years where we're at or modestly below our growth targets. Based on our current views of travel demand next year and the cadence of converting Government Solutions backlog to revenue, we anticipate Year-over-Year revenue growth at the low end of our 6 to 8 percent long-term guide in 2025. In addition, we expect growth in 2025 Adjusted EBITDA dollars to be in the low-to-mid single digits compared to 2024 as we continue to invest in business development and complete customer installs in front of expected strong revenue generation as we exit 2025 and into 2026. Craig will elaborate further on the key drivers in his remarks.

In summary, the first 9 months of the year have been great, and we're excited about our long-term outlook. We've done exactly what we said we would do in terms of financial performance. Additionally, travel demand appears to remain solid - albeit, off the 2024 highs - and the bid pipeline for automated enforcement is strong and growing. This is a great business with a bright future, and I look forward to sharing additional updates as we continue to execute against our growth strategy.

Before I conclude, I'd like to share a road safety reminder that tonight's Halloween festivities can be potentially dangerous as kids are trick-or-treating at dusk. The risk of pedestrian fatalities is 43 percent higher on Halloween compared to any other night, according to research published in the Journal of the American Medical Association, so please drive safely and responsibly.

Craig, I'll turn it over to you to guide us through our financial results, current year guidance and a high-level preview of 2025 financial estimates.

<u>Craig Conti, CFO</u>

Thank you David and hello everyone … appreciate you joining us on the call today. Let's turn to slide 4 which outlines the key financial measures for the consolidated business for the third quarter. Our Q3 performance was right on plan, which included 8 percent services revenue growth and 7 percent total revenue growth.

The Service revenue growth, which is primarily recurring revenue, was driven by strong third quarter travel demand in the Commercial Services business and service revenue growth outside of New York City in the Government Solutions business. At the segment level, Commercial Services revenue grew 11 percent year over year, Government Solutions service revenue increased by 7 percent over the prior year while T2 Systems SaaS and services revenue declined 4 percent over the third quarter of last year.

Product revenue was $8 million for the quarter … GS contributed $5 million and T2 delivered about $3 million in product sales overall for the quarter.

Our consolidated Adjusted EBITDA for the quarter was $105 million, an increase of approximately 8 percent versus last year with margins flat year over year.

We reported net income of $35 million dollars for the quarter, including a tax provision of about $14 million, representing an effective tax rate of 28 percent. This rate includes certain discrete items which favorably impacted the tax rate for the quarter – for the full year, we're anticipating an approximate 30 percent effective tax rate.

GAAP EPS was $0.21 per share for the third quarter 2024 as compared to $0.18 for the prior year period. Adjusted EPS, which excludes amortization, stock-based compensation, and other non-recurring items, was $0.32 per share for the third quarter this year, compared to $0.29 per share in the third quarter of 2023, representing 10 percent year-over-year growth.

Cash flows provided by operating activities totaled $109 million and we delivered $85 million of free cash flow for the quarter which was above our quarterly run-rate due to a catch-up on cash collections and other non-recurring working capital items.

Turning to slide 5 … we've generated $391 million of Adjusted EBITDA on approximately $869 million of revenue for the trailing twelve months, representing a 45 percent adjusted EBITDA margin. Additionally, over the trailing twelve months, we generated $172 million of adjusted free cash flow, or a 44 percent conversion of Adjusted EBITDA, on a weighted average base of approximately 168 million shares.

Next, I'll walk through the third quarter performance in each of our three business segments beginning with Commercial Services on slide 6. CS year-over-year revenue growth was 11 percent in the third quarter. RAC Tolling revenue increased 6 percent, or about $5 million over the same period last year, driven by strong travel volume and increased rental volume. Our FMC business grew 9 percent, or about $1 million year-over-year, driven by the enrollment of new vehicles and tolling growth from existing and newly enrolled FMC customers. Additionally, the combination of Title & Registration, Violations Management, Europe and other revenue contributed approximately $4 million of revenue growth for the quarter.

Commercial Services' Segment profit margins expanded about 30 basis points to 67 percent, driven by volume leverage from the summer driving season.

Turing to slide 7, Government Solutions had strong service revenue growth in the quarter, driven by 12 percent growth outside of New York City. Total Revenue grew 6 percent over the prior year quarter.

Segment profit was $28 million for the quarter, representing margins of 29 percent. The reduction in margins versus the prior year is primarily due to increased spending on business development efforts, the non-capitalized portion of our platform investments and a favorable non-recurring bad debt adjustment in the prior year period.

Let’s turn to slide 8 for a view of the results of T2 Systems which is our parking solutions business segment. We generated revenue of $21 million and Segment profit of approximately $4 million for the quarter. SaaS and services sales were down 4 percent; or $700,000, from the prior year quarter, while product revenue was down 7 percent; or $300,000 compared to last year.

Breaking the SaaS and Services revenue down a bit further, pure SaaS revenue grew low-single-digits over the prior year quarter. However, offsetting this increase was a decline in installation and other professional services due to the reduction in product sales over the past three quarters.

OK, let’s turn to slide 9 and discuss the balance sheet and take a closer look at leverage.

As you can see, we ended the quarter with a net debt balance of $844 million, down significantly on a sequential basis due to our strong free cash flow generation this quarter. We ended the quarter with net leverage of 2.2x and we’ve maintained significant liquidity with our undrawn credit revolver.

Our Gross Debt balance at year-end stands at about $1.1 billion, of which approximately $700 million is floating rate debt. Based on the SOFR forward yield curve, we opted to utilize our early termination option and cancel the entirety of our Float-for-Fixed rate swap. Consequently, the Term Loan is now fully floating.

In addition, subsequent to the end of the third quarter, we completed a successful re-pricing of our $700 million Term Loan B. The repricing was materially over-subscribed and we achieved a 50-basis point reduction in the coupon rate, lowering it to SOFR + 2.25%. The transaction yields about $10 million in cash savings, net of fees, over the remaining life of the debt. On our total debt stack, this lowers our weighted average cost of debt to about 6.5 percent at current SOFR levels. This was our second successful debt re-pricing this year – the cumulative effect being a reduction in our spread of a full 100 basis points this year.

OK, lets turn to slide 10 and have a look at Full-Year 2024 guidance … Revenue, Adjusted EBITDA and Adjusted EPS **remain unchanged however we are increasing** Adjusted Free Cash Flow to the **upper-end of the range.** For purposes of review, I'll give you a quick run through of our total year guidance by major category:

- We expect total revenue growth of approximately 8 percent … and Adjusted EBITDA margin expansion of about 50 basis points … compared to 2023
- Adjusted EPS is expected at the upper end of the $1.15 to $1.20 per share range
- Adjusted free cash flow is **now** anticipated to be at the upper end of the range of $155 to $165 million driven by lower Capex spending … we expect to spend about $75 million in 2024 Capex. The lower Capex spend is partially offset by an increased use of working capital

- And finally … we expect Net Leverage will land at approximately 2.0x, assuming no additional capital allocation investments beyond the investments we've made through the third quarter.

Our revenue guidance incorporates a modest reduction in RAC tolling driven by historical fourth quarter travel trends as well as certain temporary Florida toll road suspensions stemming from Hurricane Milton. Government Solutions service revenue is expected to be up slightly in the fourth quarter, due to customer installs generating incremental ARR. Finally, Parking Solutions revenue is expected to be flat sequentially in the fourth quarter.

Additionally, at the total company level, we expect sequential margin expansion in the fourth quarter, commensurate with our guidance.

Other key assumptions supporting our adjusted EPS and adjusted Free Cash Flow outlook can be found on slide 11.

Now let's move on to a brief preview of how we expect 2025 will play out … I'll remind you that our annual operating plan is not yet complete so these estimates may change.

As David mentioned, we currently anticipate revenue growth at the low end of our 6 to 8% long-term guide next year. This is largely driven by three factors

- First, we're anticipating that TSA passenger volume growth will decelerate and will be commensurate with GDP-type growth next year, which impacts Commercial Services revenue growth.
- Second, we expect flat revenue from our largest customer, New York City, while we await the outcome of the competitive procurement.
- And lastly, while we've had a terrific year generating new ARR bookings in our Government Solutions business, it may take up to 18 months to convert this backlog into full run-rate revenue.

From a profit perspective … we expect Adjusted EBITDA dollars to grow low-to-mid-single digits in 2025 driven primarily by portfolio mix, TAM execution costs and financial infrastructure investments. Let me give you a bit of detail on each of those drivers:

- The TAM execution cost item is largely driven by our Government business as we incur incremental business development and project go-live costs in advance of converting our growing backlog to revenue
- The financial infrastructure item relates to our previously discussed in-flight replacement of our aging ERP … we expect to incur about $5MM of non-capitalized costs in the first half of the year to complete this project …. these project costs are one-time in nature and will not continue past 2025.
- The portfolio mix is primarily in our Commercial business where we expect travel **growth** year-over-year however that growth will be moderated relative to other growth drivers in the business limiting margin expansion

From a cash perspective at the total company level, we anticipate our 2025 free cash flow to adjusted EBITDA conversion to be about 40 to 45%.

Finally, as David indicated, we have approximately $50 million left on our open share buyback authorization. Consistent with our past practice, we will evaluate the optimal returns for capital deployment and execute accordingly.

In summary, the core fundamentals of the business are strong – we think travel demand is resilient and our bookings in GS are healthy leading to strong recurring revenue growth in the future. Additionally, we have identified a path to recovery and growth in the parking business. On the basis of these trends, we anticipate that our long-term outlook remains intact relative to the Revenue and Adjusted EBITDA targets we provided at our July 2022 Investor Day.

This concludes our prepared remarks … thank you for your time and attention today … at this time I'd like to invite the operator to open the line for any questions.