Company: **Willdan Group, Inc.**

Conference Title: **Third Quarter 2016 Conference Call**

Moderator: **Tony Rossi**

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Operator: Good day, and welcome to the Willdan Group Third Quarter 2016 Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Tony Rossi. Please go ahead, sir.

Tony Rossi: Thank you, Lynn. Good afternoon, everyone, and thank you for joining us to discuss Willdan Group's financial results for the Third Quarter ended 30th September 2016. With us today from Management are Chief Executive Officer, Thomas Brisbin, Chief Financial Officer, Stacy McLaughlin, and Mike Bieber, President of Willdan Group. Management will review prepared remarks, and we will then open up the call to your questions. Statements made in the course of today's Conference Call, which are not purely historical, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements involve certain risks and uncertainties, and it is important to note that the company's future results could differ materially from those in any such forward-looking statements. Factors that could cause actual results to differ materially and other risk factors are listed from time to time in the company's SEC Reports including but not limited to the Form 10K for the year ended 1st January 2016 and subsequent Quarterly Reports on Form 10Q. The company cautions investors not to place undue reliance on the forward-looking statements made during the course of this conference call. Willdan Group disclaims any obligation and does not undertake to update or revise any forward-looking statements made today.

In addition to GAAP Financial Results, Willdan also provides non-GAAP Financial Measures that we believe enhance investors' ability to analyze our business trends and performance. Our non-GAAP Measures include revenue, net of subcontractor costs, and EBITDA. We believe revenue, net of subcontractor costs, allows for an improved measure of the revenue derived from the work performed by our employees. EBITDA is a supplemental measure of operating performance which removes the impact of certain nonrecurring income and expense items from our operating results. GAAP reconciliations for both of these non-GAAP measures are included at the end of the earnings release we issued today.

With that, I will now turn the call over to Chief Financial Officer, Stacy McLaughlin. Stacy?

Stacy McLaughlin: Thanks, Tony. I'd like to add my welcome to those joining us on today's call. I'll start with an overview of our Income Statement, then our Balance Sheet, and finally our guidance. Total contract revenue for the Third Quarter of 2016 increased 75% to $58.7 million from $33.5 million for the Third Quarter of 2015. Genesis Engineering, the firm we acquired in March 2016, contributed $16.2 in contract revenue for the Third Quarter of 2016. By segment, including both organic and acquisitive revenue, Energy Efficiency Services increased 136% to $42 million, Engineering Services contract revenue increased 11.4% to $12.9 million. Revenue from Public Finance Services decreased 2.6% to $3.2 million, and Homeland Security Services revenue decreased 31.7% to $567,000 in the quarter. For the purposes of calculating our organic growth in the quarter, we are including the revenue generated by Genesis Engineering that exceeds the revenue recorded in the same period of the prior year. In the Third Quarter of 2015, Genesis generated $7.7 million in total contract revenue. The year-over-year difference of $8.5 million is used for the calculation of our organic growth. Since the acquisition, we have won joint programs where all of the revenue is being reported under the Genesis Legal Entity. Thus, the growth in Genesis Revenue is reflective of our organic business development efforts and is counted in our organic revenue.

Net revenue, defined as contract revenue minus subcontractor services and other direct costs was $26.5 million, an increase of 30.6% from $20.3 million in the year-ago quarter. Direct costs of contract revenue were $42.6 million for the Third Quarter of 2016, compared with $21 million in the same period last year. Genesis Engineering accounted for $14.7 million of the direct costs in the Third Quarter of 2016. Excluding the impact of Genesis, the direct costs of contract revenue increased by approximately $6.9 million primarily as a result of the growth in total contract revenue in the Energy Efficiency Services segment and the corresponding increase in subcontractor services and other direct costs.

General and administrative expenses for the Third Quarter were $13.1 million compared to $10.9 million for the prior year period. As a percentage of total contract revenue, our G&A expenses were 22.3%, compared with 32.6% in the Third Quarter of 2015. The improvement in this ratio was primarily driven by increased efficiencies and greater operating leverage as we scaled the company. G&A grew 20% quarter-over-quarter, while Revenue grew 75% over the same time period, indicating that our back office costs are growing at a far slower rate than revenue. Operating income was $3.1 million for the Third Quarter of 2016 compared with $1.6 million generated in the Third Quarter of 2015. EBITDA was $4 million for the Third Quarter of 2016 compared with $2 million for the Third Quarter of 2015. EBITDA margin for the Third Quarter was 6.8%, an increase of 90 basis points from the same period in the prior year.

Income tax expense was $548,000 in the Third Quarter of 2016, compared with $626,000 in the same period last year. Our effective tax rate in the Third Quarter of 2016 was 18.2%, down from 44.5% last year. As we indicated last quarter, we have been able to reduce our effective tax rate through the increased use of energy tax deductions that are now available to us due to our move into performance contracting. The effect of these energy tax deductions on the forecasted annual effective tax rate is a reduction of 10.3% as of Q3, which reduces the effective tax rate for the entire company to the 28% range. As part of our overall tax strategy, we continue to look at two other initiatives to reduce our effective tax rate. R&D tax credits and California State Tax Planning. I just want to point out: Outside of our tax strategy, on an operating basis, our EBITDA doubled compared to the same period last year.

Net income for the Third Quarter of 2016 was $2.5 million, or 28 cents per diluted share, compared to net income of $782,000, or 10 cents per diluted share, for the Third Quarter of 2015. We have seen a significant improvement in our cash flow generation this year due to the combination of our higher revenue and lower tax rate. Through the first nine months of fiscal 2016, we have generated $16.7 million in cash flow from operations, up from $5.7 over the same period last year.

Turning to our Balance Sheet, we had cash and cash equivalents of $18.6 million on 30th September 2016, up from $10.5 million at 1st July 2016. The increase is primarily due to the net income generated during the Third Quarter and strong collections on Accounts Receivable. With the strong collections, our DSO declined to 64 days at 30th September 2016, down from 70 days at the end of last quarter. This quarter's DSO of 64 days is Willdan's best performance ever and, and means that our conversion of revenue to earnings to cash flow has never been more efficient. Since the acquisition of Genesis, we have made improvements in our collection efforts, which has driven most of the improvement in DSO over the course of this quarter. As of 30th September 2016, we have no outstanding borrowings under our revolving line of credit and approximately $1.6 million outstanding on our term loan facility.

Turning to the outlook, we have raised our financial targets for 2016 due to better performance year-to-date and higher expectations for Q4. We now expect full-year revenue to range between $190 million and $195 million. We now expect that our 2016 diluted earnings per share will range between 92 and 97 cents. This implies that we expect to grow revenue by about 40% and grow EPS by about 80% in 2016. We expect our annual effective tax rate to be approximately 28% for the year.

Before I conclude, I would like to mention that we are currently analysing our segment reporting, and it is likely that we will consolidate some of the segments in our next 10K filing. We will update you on this result next quarter.

I would now like to turn the call over to Tom.

Thomas Brisbin: Thanks, Stacy, and good afternoon, everyone. We had another good quarter. Execution on our current programs and winning new work continued to build a foundation for strong growth in the years ahead. On a year-over-year basis, we had strong growth in revenue and profits. Both energy efficiency and engineering were the primary drivers. Willdan's organic growth was 30% year-to-date and 42% for the Third Quarter.

Moving to the performance of our individual segments, I will start with Energy Efficiency. As Stacy stated, on a year-over-year basis, Energy Efficiency revenue was up 136%. Similar to last quarter, the largest contributor to our revenues were major utilities, Con Edison, San Diego Gas and Electric, Southern California Edison, Puget Sound and Universities. We continue to see excellent results from our joint business development efforts with Genesis. We recently won a program with the New York City Housing Authority in which the combined experience and expertise of Willdan and Genesis was a key factor in the award. Genesis also continues to build on its roster of college and university clients and added two new projects during the Third Quarter that will contribute to our revenue in Q4 and 2017. The success in delivering for our utilities continues to open up growth opportunities. During the Third Quarter, we were awarded a new three-year, $35 million contract by PacifiCorp to implement its small business Direct Install an Oil & Gas Energy Efficiency Program in Utah. This is a significant increase in the size of the Energy Efficiency Programs currently being implemented in Utah. We are seeing modest revenue from this program as it ramps up in the second half of 2016, and then it will make a larger contribution in 2017.

This office has already brought in another significant piece of business by winning a $1.2 million performance contract for a major hospital network. This project will be largely implemented during the Fourth Quarter.

Another market entered is New Jersey. During the Third Quarter, we were awarded a Direct Install program as part of New Jersey's Clean Energy Program. The contract term is for two years with extensions, and we expect it to contribute approximately $5 million per year in revenue over the life of the contract.

Over the past few months, we have also seen some very positive developments for growth of our energy efficiency business in California. Currently, 20% of the Energy Efficiency Services are outsourced by the three industrial-owned utilities -- PG&E, SCE and SDG&E. Currently, the annual budget is approximately $1.8 billion. In August, the California Public Utilities Commission mandated that the amount of energy segments outsourced exceeds at least 60%. We expect the procurements for the new outsourced programs to begin in 2017and continue into 2018. This new mandate will dramatically increase the market for energy efficiency in California. We are well positioned to win additional business as the new procurements are initiated.

Turning to the engineering segment, revenue was up 11.4% over last year. The growth & engineering revenue is being driven by greater demand in our California and Arizona cities. In public finance, our revenue is down slightly from last year but has remained relatively stable in the low $3 million per quarter range throughout this year. We won 70 new contracts with a total value of more than $1.6 million in Q3.

And financially, in Homeland Security, we won long-term contracts to provide training and exercise services to the cities of Chicago and Santa Ana. We also started the FEMA National Exercise Program in the Western United States. This will be a real plus for Homeland Security.

So far in 2016, we have done an excellent job driving profitable growth by also winning a number of significant programs that position us to deliver sustainable growth in the coming years. I want to take a minute to review the major new programs that we've announced this year and update the expected timing of their impact on our financial results.

The six-year, $90 million LCR program for SDG&E that was announced in March is expected to start ramping up in 2017. The 2.5-year, $41 million multi-family program for Con Ed that was announced in June has already gotten off to a strong start and will continue to ramp up and make a larger contribution next year. The three-year, $35 million contract, which is the Small Business Direct Install and Industrial Sector program for PacifiCorp in Utah will contribute a little bit of revenue this year and then increase in 2017. The two-year, $10 million contract for New Jersey Clean Energy Program will contribute a little this year as well, but, before increasing in 2017. And the large New York City Housing Authority Program is contributing a modest amount of revenue during the second half of 2016 and is expected to increase considerably next year. We only have a notice to proceed on a small portion of the program. The contract is currently under negotiation, and we will know more by the end of the year. And while a few smaller programs will end in 2016, all of our major ongoing programs are expected to remain in place at their current revenue levels in 2017.

Given the dramatic growth we are experiencing, the Board of Directors determined that we need to expand our management structure. This will position us for continued growth as well a lay the foundation for our succession planning. Accordingly, we announced today that Mike Bieber, our Senior Vice President of Corporate Development has been appointed to the position of President of Willdan. Daniel Chow, the President and CEO of Willdan Engineering has been appointed to the newly created position of Chief Operating Officer of Willdan. Paul Whitelaw has been promoted to Senior Vice President of Business Development for Willdan. Mike has been instrumental in leading our MNA efforts that have expanded our energy efficiency capabilities. Daniel has done an excellent job leading our Engineering Services segment and has consistently grown our client base and generated higher levels of revenue and profits. Paul has extended his involvement to national programs that have established Willdan as one of the leading providers of energy efficiency services in the country. I will continue to serve as CEO at Willdan, and yesterday, I was also elected Chairman of the Board of Directors. I look forward to working closely with Mike, Daniel, Paul and the rest of our team to continue implementing our growth strategies and creating value for our shareholders.

With that, I would now like to turn the call back to the Operator for questions.

Operator: And at this time, if you would like to ask a question, please press the star and one on your touchtone phone. We'll go ahead and take our first question from Al Kaschalk from Wedbush Securities. Please go ahead. Your line is open.

Al Kaschalk: Good afternoon, everybody. Can you hear me okay?

Stacy McLaughlin: Hi, Al.

Toni Rossi: Hello, Al.

Al Kaschalk: Sorry for the connection. Excellent Quarter. First of all, Tom, you, you provided some good color on the utilities, and I'm wondering about some of the other opportunities outside of utilities that can continue to build your backlog. Can you comment on any recent developments there that you may have?

Thomas Brisbin: Well, with the acquisition of Genesis 360 and Abacus, you know, we call them the end-users because people like hospitals, universities, hospitality, and the people we serve under utilities, the performance contracting business is poised to grow. I mean, Genesis is growing, 360 is growing, and Abacus will be growing, and they will be feeding not only off their, you know, usual business but the combined efforts of the, let's call it clients we serve through utilities. So, we see the end user of electricity -- hospitals, I'll say again, universities, schools, data, data centers -- we see performance contracting through our performance contracting acquisitions growing.

Al Kaschalk: Okay, that's helpful. But, now we have a small election coming up next week. Have you seen any slowdown in work being let out or opportunities to bid just across the board in general? You have enough to work on, but I'm just wondering about filling that backlog.

Thomas Brisbin: I would say no matter what happens, it will not affect this market. That's a pretty strong statement, I understand, but this, this is not being driven by politics. It's being driven by the need to reduce the amount of electricity we use.

Al Kaschalk: Got it. And then, I'd be remiss, or you may be remiss if you didn't talk about the microgrid. I didn't hear any comments during the prepared remarks. Maybe I missed it, but any update there would be great. Thank you and good luck.

Thomas Brisbin: No update at this point. I can, I can say that California is behind New York. We have submitted three new proposals into California for microgrid activity. I think, if I was to make a statement, California is going to come on very quickly in the microgrid world.

Al Kaschalk: Okay, great. Thank you very much.

Operator: Thank you, and as a reminder, that is star and one to ask a question, and we'll go next to Ryan Cassil with Seaport Global. Please go ahead. Your line is open.

Ryan Cassil: Good evening. Congrats on the Quarter.

Stacy McLaughlin: Thank you.

Ryan Cassil: And I guess congrats to Mike and the team on the, on the new appointments there as well.

Thomas Brisbin: Thanks, Ryan.

Ryan Cassil: Yeah, no worries. Just to start out here, you, you mentioned that in California, the outsource initiative to be, you know, 60% or more. Could you just refresh us on what that, where that currently stands? Is it 50%, or can you just help us with that, you know, metric there?

Thomas Brisbin: The PUC, yeah, the PUC on the special tax that we all pay collects about $1.8 billion from the rate payers, which they distribute to the utilities. Right now, about 20% is outsourced to contractors. We would be considered a contractor, and the PUC just mandated that at least 60% plus -- they used words as high as 100% -- must go to contractors. So you could take that anywhere from a three-fold to a five-fold increase of energy efficiency services being performed by contractors in California.

Ryan Cassil: And what would you say that number is now? Is there a way to kind of compare what it was?

Thomas Brisbin: It's 20% now.

Ryan Cassil: 20%?

Thomas Brisbin: 20%, and, yeah, but the PUC mandated, mandated at least 60, and they're hoping for 100.

Ryan Cassil: Got it. That's, that's great. Do you think the opportunity for you guys -- you've been expanding from small business. You've been running multi-family, commercial, industrial --

Where do you think the biggest opportunities are? Does it continue in that small business, or is it more broad-based? And could you maybe talk also to, to how the multi-family ramp is going with Con Edison there? I know it's early innings, but any thoughts there, as well, would be great.

Thomas Brisbin: The ramp on multi-family is going very well. We have no issues. We're delivering ahead of target. So, with regards to where the future is, I would say it's going to be a combination of commercial and industrial for the utilities. We have no intentions at this time to go into residential, so that really leaves commercial and industrial, and those are the programs that we want to follow with utilities. So, I think for Willdan, we need to get deeper into the industrial markets. Our commercial segments and commercial would be like hospital schools. The larger industrial would be like oil and gas refining, and we have just won a few programs in that area.

Ryan Cassil: And those are typically the larger contracts versus the small business?

Thomas Brisbin: Not necessarily. They're, the end users are larger users of electricity, so, there's a potential for greater savings. So, generally the amount per user, in terms of savings is higher. The dollars are higher, so you're seeing fewer customers with higher dollars.

Ryan Cassil: Okay. Got it. Could you just talk about the market landscape a bit. You guys have been winning, and, and it's showing up in your growth rates and your, and your award rates. Could, could you just talk about the competitive landscape and what you're seeing out there. I know there's a number of smaller private guys and, you know, a larger competitor that has presence in the business. Any changes in that landscape that you think you're benefitting from, or is there just the plethora of work that, you know, is rising tide with all those?

Thomas Brisbin: I don't know that "plethora of work" would be a good way to look at it. We see stiff competition everywhere. We've been very fortunate in not only retaining our incumbencies but taking work from others, and I would have to say it comes down to the simple thing of providing excellent service. So, we focus very hard on doing A+ work for our customers, and that translates to -- I won't say easier -- but it certainly is a lot easier to win other work with other utilities if we performed A+ for the ones we have. Take that as the number one thing.

Ryan Cassil: Okay, got it. And, I guess, you, you kind of touched on my next question. You know, now that you're, you're ramping up these new contracts, you're spreading out geographically and perhaps sort of, you know, strengthening new organizational structure. The business addresses it, but sort of the execution risk as you get bigger and broader and more spread out. I mean, how are you thinking about that from, from sort of an on-the-ground execution standpoint.

Thomas Brisbin: Our new President wants to answer that question.

Mike Bieber: I think I was assigned that question. Execution is always a risk. We're very focused on it right now. As we grow with these types of growth rates, we're recruiting lots of new people right now. We're training new people. So, we're very focused on that. We haven't had any missteps right now. We don't have any large problem projects right now, so cross our fingers and knock on wood. You know, we need to keep a focus on that. It's an issue that we're focused on, but we've been able to execute well thus far.

Ryan Cassil: Okay great. Thanks, guys, on a great Quarter.

Stacy McLaughlin: Thanks, Ryan.

Operator: Thank you, and we have no further questions at this time. Oh, we do have one question that did just actually queue. We'll take it from Tom Koch from Trancoso.

Tom Koch: Yeah, hi. Good afternoon.

Stacy McLaughlin: Hello.

Thomas Brisbin: Hi.

Tom Koch: I hope you can hear me. I have a question. Back in September, it looks like, Con Ed reached a settlement with the New York PSC and a number of other parties regarding an increase in Energy Efficiency spending, rate-based Energy Efficiency spending -- I'm just reading something here -- It looks like a new $99 million will be spent from 2017 to 2019. Can you expand upon that a little bit?

Thomas Brisbin: Well, we read it also. Con Ed, Con Ed has read it also, and they are thinking about it, on how to deliver it, and we have put it into our programs. If they want to ramp us up, they will be able to. They don't, I, I don't think for the beginning of 2017, maybe even through 2017, they're looking at anything other than maybe a 25% increase in what they're doing now, and they're looking at significant increases in '18 and '19 relative to that rate case paper that was presented. The one I saw was in September. Usually it goes back to March. They may have put out a more recent one.

Tom Koch: September.

Thomas Brisbin: September, yeah. The September, 19th September one?

Tom Koch: Yeah. So, so can you talk, what, what areas, and, and is that going to go directly to your programs, not your programs? What can you say about that.

Thomas Brisbin: It will go... well, I can't say for Con Ed. Con Ed is going to have to decide what programs it goes to, but at the current pace we're at, we represent about 50% of the portfolio of Con Ed in energy savings or energy efficiency, so they have the choice to put more into C&I

rather than small business or multi-family, and I don' know how they're going to distribute it at this point in time, but they've got a lot. If, if they decide to ramp up to meet those goals, they're going to have to put it somewhere.

Tom Koch: Okay.

Thomas Brisbin: They haven't told us yet. I mean, that is like September. This is October, the 1st of November. So, we're six weeks into that, that publication.

Tom Koch: Okay, great. Another thing I was going to ask you on is regarding NIPA. Lots of articles and press about NIPA spending money in Energy Efficiency, some different programs they have, some of them very significant. I don't remember the names of them off the top of my head, but can you give us an update as to what the, what your current kind of business is with them and what the outlook is over the next several years?

Thomas Brisbin: I think they awarded 18 contracts back about six, seven months ago, of which Willdan was awarded two of them. We have received some task orders under them, so we are playing in the NIPA market as well as NYSERDA, and we are aware of what NIPA is doing. So far, it hasn't ramped up to anything close to a Con Ed type program, but we're in it. That's all I can tell you.

Tom Koch: So, are you regarding, are you talking about this Build Smart New York program?

Thomas Brisbin: Under, under NIPA? or NYSERDA?

Tom Koch: No, NIPA.

Thomas Brisbin: I can't tell you which task orders we've been given. We were given an engineering one and an energy efficiency on.

Tom Koch: Okay.

Thomas Brisbin: It's probably all 18 contracts are under the Build New York Smart -- whatever it's called.

Tom Koch: Yeah, I mean, there just seemed to be lots of articles about -- Here's another one -- $10 million of NYSERDA announces $10 million for Industrial Energy Efficiency. Funding supports clean energy projects. Large to medium-sized industrial facilities.

Thomas Brisbin: Um-hum.

Tom Koch: Anyway, so nothing specific there that you can talk about?

Thomas Brisbin: No.

Tom Koch: So, Tom, when you, you, you know, you talk about this, you guys having this pretty strong foundation for growth going into 2017, we know the project s you've already announced. You said there are a few smaller programs running off, so how do we try to size up what 2017 could be looking like based on what you are currently signed up to work on, and -- I know these roll-outs take kind of a life of their own, but, as far as timing -- What's, what's kind of a reasonable? Are, are you going to talk about this at some point? Kind of like what we're looking at into next year? I mean, I understand there's growth, but it's a little hard to figure out the magnitude.

Thomas Brisbin: Haven't we set a minimum target for bankroll of what?

Mike Bieber: Ten percent .

Thomas Brisbin: Ten percent, so, publicly, we've stated that we will grow at least ten percent. Obviously, if these programs ramp up, we hope to do better, but that's where we are. So, we believe we have the backlog of the contracts to grow ten percent right now, at least.

Tom Koch: Okay. Fair enough. One other thing, regarding California, when, when you talked about this increase in the PUC mandates to increase outsourcing, what, what area, are those, what areas, what type of programs?

Thomas Brisbin: It, it's across the board. Let's just take SCE for example. Southern California Edison runs about 120 energy efficiency programs. We do not know which ones they're going to outsource, how much they're going to outsource. All we know... or how, how they're going to do it. So, they're dealing with that right now. All we know is the PUC had mandated you have to go from 20% to at least 60 plus.

Tom Koch: What -

Thomas Brisbin: So we positioned well that, you know, to capture at least what we have, or, or at least, if they go three-fold, we hope to do at least three-fold.

Tom Koch: Yeah, so you're RFP team's going to be going full-bore here in the next year.

Thomas Brisbin: Yeah, we've been at it pretty hard for the last year, and it's going to be another year of the same thing.

Tom Koch: Okay. Thank you very much.

Thomas Brisbin: All right. Thanks, Tom.

Operator: Thank you, and at this time we have no further questions. I'd like to turn our program back over to Management for any additional or closing remarks.

Tony Rossi: Hi, I have one here somewhere. Let's see. I'd like to thank all of you for participating in our call today and for your continued interest in Willdan, and have a great day. Thank you.

Operator: Thank you, and this does conclude today's program. Thank you for your participation. You may disconnect your line at any time, and have a wonderful...