Company: **Wildan Group, Inc.**

Conference Title: **Wildan Group Third Quarter 2017 Conference Call**

Conference ID: **5266745**

Moderator: **Tony Rossi**

Date: **November 2, 2017**

Operator: Good day and welcome to the Wildan Group Third Quarter 2017 conference call. Today's conference is being recorded. And at this time, I would like to turn the conference over to Mr. Tony Rossi. Please go ahead sir.

Tony Rossi: Thank you. Good afternoon everyone and thank you for joining us to discuss Wildan Group's financial results for the third quarter ended September 29, 2017. With us today from management are Chairman and Chief Executive Officer Thomas Brisbin, Chief Financial Officer Stacy McLaughlin, and Mike Bieber, President of Wildan Group. Management will review prepared remarks and 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's 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 December 30, 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. Wildan Group disclaims any obligation and does not undertake to update or advise any forward-looking statements made today.

In addition to gap financial results, Wildan also provides non-gap financial measures that we believe enhance investors' ability to analyze our business trends and performance. Our non-gap measures include revenue, net of subcontractor services and other direct costs, and EBITDA. We believe revenue, net of subcontractor services and other direct 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 non-recurring income and expense items from our operating results. Gap reconciliations for both of these non-gap 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 2017 increased 17.6% to $69 million from $58.7 million for the third quarter of 2016.

By segment, including both organic and acquisitive revenue, energy efficiency services revenue increased 19.2% to $50 million. Engineering services, contract revenue increased 16.1% to $15 million. Revenue from public finance services increased 2.3% to $3.3 million. And homeland security services revenue increased 27.7% to $724,000 in the quarter.

Our total contract revenue included incremental contract revenue of $.5 million attributable to the acquisition of integral analytics which is included in our energy efficiency services revenue. The organic growth rate was 16% over the prior year period.

Net revenue, defined as contract revenue minus subcontractor services and other direct costs, was $31.7 million, an increase of 19.5% from $26.5 million in the year ago quarter. Direct costs of contract revenue were $48.7 million for the third quarter of 2017, an increase of 14.5% from $42.6

million in the same period last year. The increase was 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 material costs related to the implementation of new contracts.

Our direct costs of contract revenue were 70.6% of our total contract revenue in the third quarter of 2017 down from 73.8% in the second quarter of 2017. As we discussed in our last two conference calls, we believed that the percentage of subcontractor services and other direct costs would trend downward. This quarter demonstrated this trend. As we move from 58% subcontractor services and other direct costs to 54% this quarter, this change has - this change also positively impacted margin in the quarter.

General and administrative expenses for the third quarter were $16.1 million compared to $13.1 million for the prior year period. As a percentage of total contract revenue, our G&A expenses were 23.3% compared with 22.3% in the third quarter of 2016. The increase in G&A as a percentage of total contract revenue over the prior year was primarily attributable to higher stock based compensation expense and an increase in depreciation and amortization.

Operating income was $4.2 million for the third quarter of 2017, an increase of 37% over $3.1 million generated in the third quarter of 2016. EBITDA was $5.8 million for the third quarter of 2017 compared with $4 million for the third quarter of 2016. EBITDA margin for the third quarter was 8.4% up from 6.8%. As a percentage of our net revenue, our EBITDA margin was 18.3% in the third quarter, an increase from 14.9% from the same period last year.

We recorded income tax expense of $1.3 million in the third quarter of 2017 compared to $548,000 in the same period last year. Our effective tax rate in the third quarter was 30.9% up from 18.2% in the year ago period. The increase in our effective tax rate is due to the energy efficiency commercial building tax deductions that we utilized in 2016 which have not yet been approved by Congress for this year.

Net income for the third quarter of 2017 was $2.9 million or 31 cents per diluted share compared to net income of $2.5 million or 28 cents per diluted share for the third quarter of 2016. In summary, income from operations has increased more than twice as fast as revenue to 37% over the prior period. Had we been able to utilize the 179D tax deductions as we have in the past, our EPS would have been approximately 37 cents.

Turning to the balance sheet, we had $5.6 million in cash and cash equivalents at September 29, 2017 which is a decrease of $17.1 million since the beginning of the fiscal year. The decrease was primarily driven by the use of cash for the acquisition of integral analytics and payments for contingent consideration and on notes payable related to our prior acquisitions. This was partially offset by cash generated from operations.

Our DSO was 74 days at September 29 up from 64 days at the end of the prior quarter. Since the end of the third quarter, we have worked down our DSO to 70 days. The improved collections has had a positive impact on our cash balances, which have increased to $7.3 million as of the end of October. As of September 29, 2017, we had approximately $1.5 million in outstanding borrowings under our revolving line of credit. Compared to 2016 year end, stockholders' equity has increased 33% to $66.5 million.

Turning to our outlook for fiscal 2017, we have updated our financial targets. We have increased our full year revenue to range from $255 to $265 million. Our diluted earnings per share has changed to $1.12 to $1.18. We have increased our expected diluted share count to 9.25 million shares and have not made any changes to our forecasted depreciation and amortization. For the final quarter, we expect our effective tax rate to be 40%. I'd now like to turn the call over to Tom.

Thomas Brisbin: Thanks Stacy and good afternoon everyone. We had another good quarter with positive trends. We had strong year over year increases in revenue, operating income, EPS, and EBITDA, which is largely being driven by the performance of our energy efficiency and engineering service segments.

From a client perspective, the major contributions to our revenue were largely consistent with what we have seen throughout 2017. The notable differences are primarily related to more work with end users. These include hospitals, medical facilities, financial institution schools, real estate. An example is a program to implement energy efficiency upgrades at Wells Fargo branches across the country. As a result, we're seeing a more diversified revenue mix than we have historically experienced.

The increase in these types of end user projects reflects the strong performance contracting capabilities that we have built over the past few years. We are incorporating our performance contracting groups into the business development efforts of our utility and municipal business units. The collaboration across the company has led to many cross selling successes.

Within our energy efficiency programs for utilities, we continue to execute well and deliver the energy savings that we are targeting. As a result, we have won all of the re-competes that have come up for bid this year. And the outlook for this area of the business continues to be strong. We continue to see more work coming from different areas of the country. At the same time, the opportunities to expand our business when in California are substantial.

As we announced earlier this year, we have been awarded two new master service contracts to perform energy efficiency and water conservation upgrades in facilities managed by the State of California's Department of General Services. These contracts have the potential to contribute meaningful revenue over the next eight years and we have received our first assignment under this contract to perform upgrades on a 22 story building in Oakland.

As you know, we have talked about the mandate to increase the amount of outsourcing by California utilities to bridge the procurement period while this new initiative is implemented. All of the existing energy efficiency programs have been extended at least through 2018. Thus, we have good visibility on our California related revenue going to - going into the next year.

We anticipate the first awards for the newly outsourced programs will be made in late 2018 or early 2019. Winning as much of the new programs to be outsourced in California is a top priority for the company right now. We're committing more resources to developing our proposals. In fact because of the expanded array of energy efficiency services and solutions that we cannot provide, the number of markets that we can serve and the types of clients that we can target, we have more business development activity ongoing than at any point in our history.

We believe we will see strong dividends in the form of continued organic growth in the years ahead. We are incorporating our new data analytics capabilities via integral analytics into many of our proposals. We believe this is going to be a significant differentiator that will enhance the value to our utility customers.

On a standalone basis, integral analytics continues to win new business including the license agreement recently signed with Hawaiian Electric. And we anticipate seeing a meaningful amount of higher margin licensing and maintenance revenue in 2018. We are very excited about our outlook for continuing to drive profitable organic growth.

We also intend to continue our M&A strategy that has proven highly effective in improving our financial performance and position in the company for distributed energy resource solutions. For example, our air quality manage of a district award $7 million CEC award is a beginning of several micro grid awards being procured in California. We expect to pursue schools, universities, military bases and any area that needs resiliency.

In closing, we are filing an S3 shelf with the SEC tomorrow. While we don't have any current plans to use it, it allows us to be opportunistic with respect to future acquisition opportunities. With that, I would now like to turn the call back to the operator for Q&A.

Operator: Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again press star one to ask a question. And we'll pause for just a moment to allow everyone an opportunity to signal. And we will take our first question from Mike Shlisky with Seaport Global.

Mike Shlisky: Good afternoon everybody. I kind of want - can you hear me okay by the way?

Thomas Brisbin: We can.

Stacy McLaughlin: Yes. Hi.

Mike Shlisky: Hello? Okay, great.

Thomas Brisbin: Mike, we can hear you…

Mike Shlisky: I want to start.

Thomas Brisbin: Sorry.

Mike Shlisky: Perfect. Thank you so much. I wanted to start off by just looking to your guidance just for one second here. Maybe I'm looking at this wrong with my calculator but are you going through a revenue decline in the fourth quarter? And is there any reason why that might be the case? It was in a very tough comp from last year.

Thomas Brisbin: Hi Mike. If you look at our updated guidance, you know, we raised the top end - the top and bottom end of guidance 255 to 265. If you just do the pro forma, we had a very strong Q4 last year especially from engineering. We had some unexpected revenue there. If you do the math, there's a slight decline in Q4. We don't know that that will occur as we beat guidance on revenue, I think for each of the last six or seven quarters.

But when you're going into Q4, you often don't know what kind of year end spending the customers, especially the large utilities, have. You don't see that until November and December. So this is - this represents, you know, a view as we see it today and we're optimistic that, you know, we're going to continue our good growth trends.

Mike Shlisky: Okay. Got you. So then I mean then more broadly speaking you do feel good that the organic growth rates are still pretty much going to grow for you in the double digits, maybe not every single quarter but certainly that's the general trend for most quarters going forward.

Thomas Brisbin: Yes. That's correct.

Mike Shlisky: Okay perfect. Just wanted to make sure. Going even broader here, I wanted to just talk about next week for election day are there any states or cities that you're watching that have either some kind of referendum out there on changes to their local industry policy or any candidates that you're watching that might be looking at a more favorable tone towards what you do for your work over there?

Thomas Brisbin: Our answer would be no. We don't see any of the elections affecting anything we do. We are watching what's going on in the tax world hoping that our tax credits for energy get passed before the end of the year. But that's the only political thing that we're watching.

Mike Shlisky: Got you. Then I just want to touch on the IA business. I wanted to get your impressions now that you've owned it for a couple of months now. And what are your first impressions and, you know, kind of seeing on a more granular level? And how's it been with the big change that you've made at that organization now that you officially own it?

Thomas Brisbin: You broke up a little bit on that one. Did you hear it Mike?

Mike Bieber: He just wanted to talk about IA.

Thomas Brisbin: IA?

Mike Bieber: Go ahead.

Mike Shlisky: Yes I was just curious if you could tell us now that you've owned it for a couple of months kind of now that you've seen it a little more closely if you've made any big changes. Are you satisfied with what you've seen so far? Kind of your thoughts as to what's been surprising to you over the first few months of ownership.

Mike Bieber: We haven't made any changes to the business. We've integrated the back office. We did that actually before we closed the transaction. So they're on our accounting system. We've had a lot of collaboration with IA on the new bids that we are going after. And I guess the one thing that we've actually seen is that clients when go to oral interviews respond very positively to the ideas that we can put forth using IA tools and concepts about modeling different scenarios, that a lot of these ideas are new to these utility customers. And so that's we're seeing. It - they're very impressed with that and we think it's a good technical differentiator.

Mike Shlisky: Okay. Got it. I also wanted to touch on the subcontractor percentage. You did promise it would come down this quarter. You said you delivered on that. I'm actually done. I kind of want to get a sense as to where you think is there an additional step down happening in Q4 or next year or have we reached a kind of appropriate level that you're looking for and kind of year to be determined?

Mike Bieber: Yes, you're right. It did go from 58% to 54% just like we thought it would. We thought it would trend down. We think it's going to, you know, continue to trend down over the next three or four quarters. It'll trend slowly down. So if we lose, you know, a % or two here or there over the next couple of quarters that's sort of what we would expect.

Don't be surprised if it moves around a little bit each quarter up or down. But the trend line over multiple quarters should follow exactly what you've seen in the last four quarters which is that it's come down from about 5%.

Mike Shlisky: Got you. Then one last one for me if you wouldn't mind on the amortization expenses. Yes I saw it clearly jump up into good will. Obviously it's ((inaudible)). Is the 1.05 we saw this past quarter is that the appropriate revenue going forward or is there still a full quarter needed there on IA in the fourth quarter and beyond for your amortization process?

Mike Bieber: Yes. We had IA for two of the three months. It is close to - you could do a pro rata calculation and you'll see the data in our queue to get the full period effect of IA. But yes that is our early estimate and we don't expect it to move around too much in the out quarters other than the pro rata portion of the quarter that they were with us.

Mike Shlisky: Okay. Super. I'll hop back in queue. Thanks so much everybody.

Operator: If you find that your question has been answered, you may remove yourself from the queue by pressing star two. And we'll take our next question from John Quealy from Canaccord Genuity.

John Quealy: Hey. Good afternoon folks. Congratulations on the quarter. A couple questions, Tom on the outsourcing initiatives in California, you know, thanks for the update around potential first awards. Can you just remind us some of the milestones in the process? Is this, you know, past the PUC? Have RFPs been issued by the constituent IOUs yet? Where are we on some of the nuts and bolts of that outlook that you gave earlier?

Thomas Brisbin: Yes the final business plans have not been approved by the PUC. We're expecting that in November. A schedule is publicly available for all of the programs and the schedule for when they expect procurements for all of the major utilities in California. So our best guess is they - it does get passed in November and we start to see the first procurements first quarter of next year. And generally that's a 10 to 12 month award cycle, so. And then they stretch out about - I think it adds up to around $600 million worth of procurements over 2018 into '19.

John Quealy: Got you. Okay. Thanks for that recap. And while I have you Tom. Go ahead.

Thomas Brisbin: No I just want to make sure I said the - I thought of another number. I said $600 million. Go ahead.

John Quealy: Okay. Thanks. So Tom while I have you a bigger question on, you know, you brought up tax policy. So talk about I mean obviously the federal tax regime is hard to speculate on but some of the things we saw today. Talk about some of the things that you're focusing on. Obviously, you know, I think you mentioned like a 179D or something or a MACRS. That's a big part of I think the business side of the initial version of the tax plan in terms of 100% expensing. Does that apply at all to your business?

And then also who knows what they do with the ITC PTC but at least the initial draft had some inflation adjustments coming out of it. Does that impact your utility related business or obviously we're driven by state rate case economics? Just help us put in what you're looking for in these tax changes and then really what drives the business or is a risk to the business if there's anything.

Thomas Brisbin: Let's first address 179. And what did you say it's going to go to legislation next week?

Mike Bieber: Correct. It's in the bill right now. It's in the House bill that will be reviewed on Monday. We don't know if that's going to pass as it has every year for I don't know 17 or 18 years in a row. However, even if it doesn't pass, the corporate tax reform is likely to lower everyone's tax rate down to the 25%. So whether it's, you know, a 25% or 30% through 179D or everyone's corporate tax rate is lowered, those seem to be the two most likely outcomes at this point.

Thomas Brisbin: Those are the two things we're watching.

Mike Bieber: Yes.

John Quealy: Got you.

Mike Bieber: ((Inaudible))…

John Quealy: And just as back - yes, right. Right. And in terms of your projects on energy efficiency or distributed energy resources, thus far the projects that you've done or the projects that you're pitching do they - how heavily do they rely on federal ITC PTC if at all?

Mike Bieber: Not at all.

John Quealy: Okay. Okay. And then the last question back I think to the earlier comment on IA and, you know, the relative happiness with it just, you know, three or four months in is that sort of $10 million revenue bogey is that still what you're thinking at this point? And, you know, just if you don't mind just coloring that in a little bit.

Thomas Brisbin: We've still got that on the books, yes, $10 million.

John Quealy: Okay.

Thomas Brisbin: Do you want more detail than that?...

John Quealy: All right. No just your conviction in it. That's good. That's good Tom. All right folks. Thank you…

Thomas Brisbin: Yes. Yes. Okay.

Operator: Once again if you would like to ask a question, please press star one. We'll take our next question from Ariel Hughes with Wedbush.

Ariel Hughes: Hey guys. Thanks for taking my question. So on the energy tax credit just how - what's the likelihood that you guys see that credit next quarter? And then just as a follow-up, you know, how should we think about your tax rate, you know, going into 2018? Do you guys expect to be awarded this tax credit again in 2018?

Stacy McLaughlin: Well I can't really speak to the likelihood of whether or not the tax credit will be passed for this year. It has been passed as Mike said every year for the past so many years. And, you know, we would hope that that would happen again this year. But as to the likelihood of that, I don't think I can make an opinion on that.

We are utilizing other tax credits to help keep the tax rate down such as R&D and California Competes and the like. So next year we'll continue to do that moving forward to try to help keep that rate down and ideally the 179D would also go into effect next year as well. But we wouldn't obviously know that until either they pass it this year or again next year.

Ariel Hughes: Got it. Thanks for taking my question.

Stacy McLaughlin: You're welcome.

Operator: And I show no other questions. I would like to turn the call back to management for any closing remarks.

Thomas Brisbin: Okay thank you. I would like to thank all of your for participating on our call today and for your continued interest in Wildan. And have a great day.

Operator: And that concludes today's conference. We thank you for your participation. You may now disconnect.