Company: **WILLDAN GROUP, INC.**

Conference Title: **Willdan Group Third Quarter 2018 Conference Call**

Conference ID: **7722489**

Moderator: **Tony Rossi**

Date: **November 1, 2018**

Operator: Please stand by. Good day, and welcome to the Willdan Group Third Quarter 2018 Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Tony Rossi with Financial Profiles. Please go ahead.

Tony Rossi: Thank you, (Vicky). Good afternoon, everyone, and thank you for joining us to discuss Willdan Group's financial results for the third quarter ended September 28, 2018. With us today from management are Thomas Brisbin, Chairman and Chief Executive Officer; Stacy McLaughlin, Chief Financial Officer; and Mike Bieber, President of Willdan Group. The management team is taking today's call from separate locations so please bear with us if there are any delays during the prepared remarks or question and answer session. Management will review prepared remarks, and then we will open up the call to your questions.

Statements made in 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 10-K for the year ended December 29, 2017, and subsequent quarterly reports on Form 10-Q. 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 investor's ability to analyze our business trends and performance. Our non-GAAP measures include net revenue, adjusted EPS and adjusted EBITDA. We believe net revenue allows for an improved measure of the revenue derived from the work performed by our employees. Adjusted EPS and adjusted EBITDA are supplemental measures of operating performance, which removes the impact of certain expense items from our operating results. GAAP reconciliations for all 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. Good afternoon, everyone, and thank you for joining us today. I'll start with an overview of our income statement, then our balance sheet and finally our guidance.

The total contract revenue for the third quarter of 2018 increased 3.4% to $71.4 million from $69 million for the third quarter of 2017. The increase was driven by growth in our engineering and consulting segment, which was partially offset by the impact of reduced pass-through subcontractor costs in our energy segment that we recognized at little to no margin. This has decreased the total amount of contract revenue running through our income statement.

Net revenue defined as contract revenue minus subcontractor services and other direct costs was $34.5 million, an increase of 9% from $31.7 million in the year ago quarter. Net revenue in our energy segment increased by 17.6% while it decreased by 1.2% in our engineering and consulting segment.

Direct costs of contract revenue were $48.1 million for the third quarter of 2018, a decrease of 1.4% from $48.7 million in the same period last year. The decrease was primarily the result of lower pass-through subcontractor expenses resulting from our energy segment projects.

Our direct costs of contract revenue were 67.3% of our total contract revenue in the third quarter of 2018, down from 70.6% in the same period of the prior year. The decline was due to lower subcontractor services and other direct costs, which represented 51.6% of total contract revenue this quarter down from 54.1% last year.

General and administrative expenses for the third quarter were $18.4 million compared to $16.1 million for the prior year period. The increase was primarily driven by higher salaries and wages, payroll taxes and employee benefits largely related to the personnel added through the acquisitions of Integral Analytics and Newcomb Anderson McCormick. We also had an increase in stock based compensation expense of $800,000. Additionally within our general and administrative expenses, we incurred over $600,000 in unforecasted third party costs associated with the Lime Energy transaction.

Operating income was $4.9 million for the third quarter of 2018 compared to $4.2 million in the third quarter of 2017. Adjusted EBITDA was $7.1 million for the third quarter of 2018. Adjusted EBITDA as a percentage of net revenue for the third quarter were 20.5%, which is in line with our expectations.

During the third quarter, we recorded income tax expense of $1.6 million representing an effective tax rate of 32.5%. During the quarter we made adjustments in tax deductions related to Section 179(d) that were recorded in Q1, which resulted in the higher than expected effective tax rate. These adjustments accounted for $420,000 of tax expense recorded in the third quarter.

Net income for the third quarter of 2018 was $3.3 million or 35 cents per diluted share which up from $2.9 million or 31 cents per diluted share in the same period last year.

On an adjusted basis, excluding stock-based compensation, amortization and transaction costs, our net income increased 40% to $6.4 million, while our adjusted EPS increased 27.3% to 56 cents per diluted share. Had our tax rate been in line with the 23% forecast, our GAAP EPS would have been 43 cents and our adjusted EPS would have been 63 cents. Normalizing for the tax rate and adjusting for Lime Energy transaction costs, the company's adjusted diluted earnings per share were slightly ahead of the analysts' consensus estimate for the quarter.

Turning to h balance sheet, we had $16.7 million in cash and cash equivalents at September 28, 2018, which was an increase of $5.5 million from the end of the previous fiscal quarter. The increase was attributable to our strong cash flow in the quarter as we generated $7.5 million from operations.

During the third quarter, we paid down $2 million on our revolving line of credit leaving us with no outstanding borrowings on our line as of September 28, 2018.

Subsequent to the end of the third quarter, in conjunction with the announcement of our acquisition of Lime Energy, we entered into a new five-year $100 million debt facility with BMO Harris and Union Bank. The committed bank facility is comprised of a $70 million, five-year term loan and a $30 million revolver with an accordion feature for another $30 million.

Upon the closing of the Lime Energy acquisition, which Tom will talk about in more detail, we would expect our interest rate to be approximately 1.75% plus LIBOR.

In October, the company issued an additional 2 million shares as part of a follow-on equity offering which provided Willdan net proceeds of $56 million. We chose to do an equity offering in conjunction with debt financing to lower our leverage ratio after completion of the Lime transaction. This will allow us to continue moving forward with other acquisitions in our pipeline. We anticipate that upon closing the Lime transaction, our leverage ratio will be approximately 1.9.

Turning to our outlook for the remainder of fiscal 2018, I would like to provide an update on our financial targets for the full year, which include the pending transaction of Lime Energy.

We anticipate the Lime transaction will close in the fourth quarter and therefore we are including the month of December, which typically has lower revenue and profitability when compared to other months. We have kept our net revenue range to be from $130 million to $140 million and our depreciation to be approximately $2.2 million. We have updated our adjusted diluted EPS to range from $1.98 to $2.03; diluted share count to increase to 10.1 million shares; and amortization expense to increase to $3.5 million. We expect our effective tax rate to be 24%.

All of these forecasted numbers could be impacted positively or negatively by the timing of the Lime acquisition close as well as the timing of contract signatures related to data analytics projects at the end of the year. I'd now like to turn the call over to Tom.

Thomas Brisbin: Okay thanks, Stacy, and good afternoon, everyone. We delivered another quarter with strong year-over-year growth and net revenue and adjusted EPS while generating over $7 million in operating cash flow. On a net revenue basis, our engineering and consulting segment was relatively flat year over year. Our energy segment was up 18%, which reflects the ramp-up of new programs, higher revenue from our Integral Analytics business and the contribution of our recent acquisition, Newcomb, Anderson, McCormick, referred to as NAM.

Organic growth for the quarter was 4% for net revenue and 6% year to date. Our marketing and new business development efforts continue to produce good results. We are steadily winning new programs that lay the groundwork for strong growth in 2019. We recently won two design build projects in Colorado with a combined value of $17 million.

These projects will focus on improving energy efficiency, upgrading aging infrastructure and modernizing educational facilities in Colorado. We will be fully responsible for the delivery of the projects including design, construction management and post project support services. These program wins are a direct result of our continued execution on two key growth strategies, one, expanding our presence in new geographic markets; and two, building our engineering capabilities.

We also won NYPA's Build Smart New York program for public facilities across the state. This award demonstrates our strong self-performance capabilities and our expertise in implementing innovative energy solutions such as solar, cogeneration systems and micro grids. SoCalGas awarded us a contract to implement natural gas energy efficiency projects for small and medium-sized lodging customers.

As we mentioned on our last earnings call, we are seeing more opportunities emerging around natural gas. And our proven track record in electrical engineering, energy efficiency programs positions us well to capitalize on this growing area of demand.

We continue to see growth with Integral Analytics. Salt River, the largest provider of electricity in Phoenix, recently selected our LoadSEER software to assist with its grid modernization strategy. In Arizona, solar power is a key source of electricity and our software will help Salt River to efficiently integrate more distributed energy resources into the grid.

The growth of Integral Analytics has tracked right in line with our expectations. So far this year we have won every major opportunity that was projected within the pipeline at the start of the year. It's a testament to the value that utilities are seeing with Integral Analytics. As we generate more sales opportunities, we should continue to see growth in this business.

We recently announced the acquisition of Lime Energy. As we said on our call a few weeks ago, it's an outstanding fit given the similarities in our business model, customer base, service offerings and corporate cultures. The acquisition will provide important scale and improved diversification from both a client base and geographic perspective. As a larger company, we believe we will be more competitive across the entire landscape of the energy efficiency services market and improve our positioning for upcoming program expansions in California, and the Northeastern United States.

Lime's second largest contract is with Duke Energy, which gives the combined entity the ability to pursue work in the Southeast. Our resume now includes work with 16 of the top 25 utilities.

Specific to the Northeastern United States, we are seeing significant growth opportunities in New Jersey. The state has restructured its energy efficiency program and is planning to double the amount of funding over the next two years. This will take the size of energy efficiency services market in New Jersey from approximately $350 million annually to approximately $600 million annually.

With the acquisition of Lime, the combined entities currently generate about $20 million annually in New Jersey. We have been growing our presence in New Jersey over the past couple of years and Lime is headquartered in New Jersey. We feel the combination of our experience in the state bodes well for our chances to capitalize on the increase in the addressable market. We expect the transaction to be closed in the fourth quarter.

Now I would like to provide a brief update on the California procurement opportunities. The RFPs for the first two procurements with San Diego Gas and Electric were announced on October 30 and others are expected to follow in the coming months. With the addition of the data analytics expertise that IA provides, the strong experience and skills of NAM and now the proven track record and technology of Lime Energy, we are well positioned to benefit from these program expansions in the coming years.

We're excited about the outlook for the company. Based on the stability in our largest customer relationships, and in new programs set to ramp, we have good visibility going into 2019; and this does not include any assumptions regarding the new California procurements. And with the acquisition of Lime Energy, we will clearly hit the 10% acquisitive growth so we are feeling very good about the end of 2018 and our position for 2019.

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 1 on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star 1 to ask a question. And we'll pause for just a moment to allow everyone an opportunity to signal for questions. And we'll go first to Moshe Katri with Wedbush.

Moshe Katri: Hey thanks. Just a housekeeping item just to start with. You mentioned an unforeseen expense of about $600,000 related to the Lime acquisition. Stacy, maybe you can give us some color on that. And then just some - maybe a big picture question, talk about the typical dynamics as we head into the Q4 in terms of budgets, funding and then spending decisions and then given where you are in terms of the pipeline, and I realize that we're not really looking in 2019 in terms of guidance yet, but how should we think about it in terms of, you know, when we're trying to model our numbers into 2019. Thanks a lot.

Stacy McLaughlin: Hi, Moshe. It's Stacy. The unforecasted costs that we incurred related to the Lime transaction relate to things such as the 8K that we had to file, we had audits done, we had consents done, it's taken a lot of management and time away from people that are also chargeable on our projects here. So there were just costs that we incurred that we weren't able to see and put into our forecasts prior to the quarter.

Moshe Katri: Great. And then the other question about the big picture looking at Q4 and then kind of general, you know, commentary on 2019?

Thomas Brisbin: Well Q4 we expect to look good. We'll finish strong as I said. And then '19, again, as I closed, we expect organic growth. The thing that is unpredictable is we stated that California has finally started coming out with procurements. It will take them probably to at least halfway through next year, towards the end of next year to start awarding them and if we are so fortunate to win, which we believe we will, the ramp up probably won't being until the end of '19. So we are counting on other wins throughout the country to give us our growth through '19.

Moshe Katri: Okay. Is there anything specific when you look at your client base that's kind of relevant when we're looking at budgeting and preparing budgets for next year? Any color there could be kind of helpful. When do you do have visibility into budgets, etcetera, once we start the year? Thanks.

Thomas Brisbin: Yes, at this point we're not expecting any contracts to roll off. We're good through 2019. All or major contracts will not be completed until 2019 going to the next cycle which is 2020-2023. So we are not aware of any major roll offs or re-competes for 2019.

Moshe Katri: All right and just final question about the tax rate. Will that follow through into 2019?

Thomas Brisbin: Stacy.

Stacy McLaughlin: Yes, we would expect around the 24% to go into 2019.

Moshe Katri: All right, thanks a lot.

Operator: We'll go next to Craig Irwin with Roth Capital Partners.

Craig Irwin: Hi, good evening and thanks for taking my questions. Really good news about San Diego Gas and Electric out with their RFQ. Can you maybe confirm for us that prior phases in the process, other utilities are out there with RFAs and RFPs already but the final contracting process is the RFQ process?

Thomas Brisbin: Craig, did you - what's going to happen in California is going to be…

Craig Irwin: Yes, yes.

Thomas Brisbin: Yes, there's going to be a request for abstract first so that's what we're looking at. And a request for abstract will be like a 10-12 page response which they will then shorten the list of competitors, we don't know, let's just say three to five, which they will give an RFP to which is a request for proposal. At that point, we will give a more detailed approach to what we are proposing and then they will have evaluators evaluate that for final selection.

Generally that's based on a quality-based selection, which means they'll look at your ideas, your thoughts, they'll rank you, they'll choose the number one firm, and then they'll bring you in for negotiation on price.

Craig Irwin: Okay, so as far as different stages in the process, you flagged San Diego Gas and Electric but there are at least two other utilities that have processes moving forward at this point, correct?

Thomas Brisbin: Yes, well actually, we're looking at four, so there's PG&E in the north; Southern California Edison in our hometown area of Southern California; San Diego Gas and Electric, San Diego; and then SoCalGas is also in the program.

Craig Irwin: Okay. And then my understanding from having participated in the stakeholder meeting, PG&E sounded like they were the furthest along. Is this consistent with what you're seeing?

Thomas Brisbin: You know, that's a monthly change. I think there's a race or sometimes a delay as to who's going to go first, PG&E or SCE but it looks like San Diego Gas got their RFAs out first. So I can't help you with that one.

Craig Irwin: Okay. Okay, no that's very good. They're all moving and that's what we like. So then…

Thomas Brisbin: Yes .

Craig Irwin: …big picture question, right, a lot of activity across the country, California I the area where we seem to have the best visibility because of the (SB350) and the commission process there and utilities taking you know, visible steps to meet their obligations. Give us a little color on the number of material projects across the country that you're chasing, things that would be, you know, bigger than, you know, low single digit millions in revenue contribution in any given year. Are we looking at a number of elephants out there? Are we looking at several projects that could materialize as potentially chunky contributions over the next couple of years.

Thomas Brisbin: The answer to that would be yes, and we'll - if we look at - well California, I think I stated before the addressable market publicly is for us is about $560 million a year so that's a pretty big chunk. If we leave California and go to the Midwest, we are following leads in Kansas, Illinois, Wisconsin, Michigan, Ohio, so we call that the Midwest and there's significant chunks in that area. And when I say "chunks" you know, greater than $10 million and less than $100 million on an annual basis.

Craig Irwin: And then East Coast, some of the gas (send-in) problems for Manhattan and other areas on Long Island, is that also an opportunity for you?

Thomas Brisbin: Yes, we submitted a proposal to ConEd on gas. I think we referred to that before, Craig, that by 2023 Manhattan, because they've changed from fuel oils to natural gas, will have a gas shortage so there's like an energy efficiency program or electrification program to take customers and convert them from natural gas to electric. That's a $100 million a year program that we're waiting to hear on and we think we're in a very good position for a - as you call it, a good chunk of that.

Then we move to New Jersey and really we're really excited about the Lime Willdan combination because New Jersey's programs are just being doubled and bumped up and we are in a great position there. So and then the Southeast, Lime works in Duke, TVA and others so we'll be able to address that. Texas is also - we're both working there and we think we can up our game there. So if you added it all up there's probably California's $500 million, you could probably come up with another $300 million, $400 million in what I talked about so you're looking at addressable market of close to $900 million.

Craig Irwin: That's really great to hear.

(Crosstalk)

Craig Irwin: Excellent, excellent. Just to change subjects, the pass-throughs are always very difficult to project in any given quarter, it looks like this quarter we did have, you know, much stronger gross revenue contribution but pass-throughs were pretty strong. Can you maybe comment for us what the driver was of the pass-throughs in the quarter and, you know, how are we likely to progress into the backend of '18 and, you know, do you expect this to become easier to predict after the Lime acquisition?

Mike Bieber: Last question first. Yes it will become easier because you know, you'll have larger base to work off of so proportional changes will be less. But you're right, we did subcontract about 51%, moved up slightly, that's just project timing, Craig. We had a couple projects that had a little more subcontractor costs this quarter. I would expect this to, you know, become more predictable into 2019 though as we grow our revenue base.

Craig Irwin: Great. And then another topic people always ask about is IA, your software acquisition. Can you maybe comment for us, you know, whether or not you implemented any significant licenses in the quarter, you know, what you think a reasonable expectation is around volumes for IA in the fourth quarter? And is this business something that should scale or continue to scale in '19?

Mike Bieber: Yes, we think we'll continue to grow in '19. They had a very good Q3. Q4 is probably the least predictable for IA because - and that's true of many software businesses, because you have customers wanting to obligate budget at the end of the year and then you also have a lot of activity right around Christmas, you know, with people going on holidays and such. So we've tried to factor that in.

But overall we did have two major deployments of IA software in the quarter. We press-announced one of those; the other was for another large client we didn't press release. And the pipeline looks good coming into 2019; it's really strengthened up over the last six months. I think we're starting to get some traction with some of these larger utilities.

Craig Irwin: Great. And then I might have missed this in your prepared remarks, but do you have an organic growth for the quarter you can share with us?

Thomas Brisbin: We said 4% for the quarter, 6% year to date.

Craig Irwin: Perfect. Thank you so much. Hey, congratulations on the progress and what a win with Lime, great acquisition.

Thomas Brisbin: Thanks, Craig.

Operator: Again press star 1 to ask a question. And we'll go next to Andrew Gordon with EF Gordon Capital.

Andrew Gordon: Hey, good afternoon guys. Hope you're all doing well and appreciate you taking my questions. Had a couple for you, the first one really quick, housekeeping, the press release at the top listed adjusted EPS as 52 cents and then it was later 56 cents and then some commentary on the call that it was 56 cents. I just want to clarify and make sure you get full credit for the 56 cents and make sure that I had that right.

Thomas Brisbin: We're looking at it right now. We're kind of scrambling looking at the paperwork to see what you're looking at, Gordon. I mean, Andrew, excuse me.

Andrew Gordon: No problem. Yes, it's up towards the header.

Thomas Brisbin: That'd be a bad place for it to be if that's true, Andrew.

Andrew Gordon: Yes, unfortunately. And then it was on Reuter. I just wanted to clarify it for the record.

Thomas Brisbin: We haven't found it yet, hang on a second.

Andrew Gordon: Okay.

Stacy McLaughlin: Okay hi. Sorry, I just wanted to check both sides. It is 56 cents so that bullet that you're looking at was not updated correctly. But the script said 56 cents…

(Crosstalk)

Stacy McLaughlin: And if I - if you go to Page 12 of the press release there's the reconciliation gets you to the 56 cents.

Andrew Gordon: Yes, I saw that as well. I just wanted to clarify because some news sources had listed 52 cents as well. So the next question is I think a more interesting one and more substantive, so big picture, the Lime acquisition I thought sounded very interesting and compelling. It obviously immediately slightly accretive and it provides a lot of scale and it significantly skews your revenue composition more towards the higher growth and less cyclical energy segment. And I understand it also opens up some nice new relationship. \

But I wonder if you could give a little more color on strategically how this changes your positioning within the broader competitive landscape and I wonder if, you know, as you were talking about, Tom, your answer to the last gentleman's questions about what are the elephants that you're still targeting, I wonder if simply the virtue of you operating a much larger scale positions you more strongly to give service to these large utilities around the country?

Thomas Brisbin: Well yes it helps us. Our feedback after this announcement has been very positive. I'll give you an example, Andrew, in California we do about $20 million a year as Willdan; Lime does about $40 million plus with LADWP. So combined we are now a $60 million a year entity just in California on energy efficiency and our next closest competitors are down in the, you know, we were in the top three at $20 million, but we are now the clear leader in California, which helps us on that addressable market of about $560 million that would be coming out over the next 18 months.

So we are very happy about the size element. But in addition to the size element, Lime brings some technology that they've been, I would say, demo-ing and executing on with (Nicerta) and National Grid on the Northeast that we believe we can, you know, show to our customers throughout the country on how to measure at the meter. So they have a few things that we do not have that will be very important in that list of chunks that we'll be pursuing.

They also I think are very good at small business direct install. That's their specialty, that's what they want to do, and that will be an important role in every procurement.

Andrew Gordon: Great. I appreciate that color. Two related questions about your ongoing organic growth, first I wonder if you could comment a little bit on the expectation - I think Lime sounded like it's growing mid-teens in 2018 and I wonder if you can comment on whether you think that new segment of your business will continue at that pace and then separately obviously your energy segments' organic growth has been fantastic for years now and continuing into this year. And it's faster than the engineering segment and your revenue composition is going to get skewed more significantly towards energy.

So I wonder if you can comment on any expectation about an accelerating consolidated organic growth rate in 2019 and beyond. I mean, I assume you'll probably maintain your 10% baseline expectation but realistically it would seem if your revenue composition is skewing this way that maybe we should expect an accelerating organic growth rate.

Mike Bieber: We've been telling investors that, you know, we expect Lime to grow in the 10% range, which, you know, if they do better than that next year we'll get into that probably later in the year as they spend more time with us and we go through our detailed budgeting process for 2019. But I wouldn't want you to get out in front of our own estimates; use 10% growth for Lime. You're right though, in that, you know, as the California procurements come on in 2019 and, you know, the tailwinds move in that direction with New Jersey and other programs, it looks good that, you know, the growth rate could potentially accelerate in the next couple of years but we'll have to win those programs and we'll give you updates as we move through that.

Andrew Gordon: Okay, I think that's it for me. I appreciate the time and help.

Operator: At this time I would like to hand the call back to management for any additional or closing remarks.

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

Operator: That does conclude today's conference. We thank you for your participation.