Willdan Group, Inc.
Fourth Quarter and Full-Year 2022 Financial Results
March 9, 2023

Presenters
Thomas Brisbin, Chairman of the Board and Chief Executive Officer
Kim Early, Chief Financial Officer
Michael Bieber, President
Al Kaschalk, VP Investor Relations

Q&A Participants
Andrew Scutt, ROTH Capital
Chip Moore, EFHutton
Marc Riddick, Sidoti & Company

Operator
Greetings, and welcome to the Willdan Group Fourth Quarter and Full-Year 2022 Financial Results Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad.

It is now my pleasure to introduce your host, Al Kaschalk of Investor Relations. Please proceed.

Al Kaschalk, VP IR
Thank you, Latania. Good afternoon, everyone, and welcome to Willdan Group's Fourth Quarter and Fiscal Year 2022 Earnings Call. Joining our call today are Tom Brisbin, Chairman of the Board and Chief Executive Officer; Kim Early, Chief Financial Officer; and Mike Bieber, President. The call today builds on our earnings release we issued after the market closed today. You may find the earnings release in the Willdan investor report that accompanies today's call and the press release and stock information section of our Investor Relations website found at ir.willdan.com.

Management will review prepared remarks, and we will then open the call up to your questions. Statements made in the course of today's conference call, including answers to your questions, which are 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 materially differ from those in any such forward-looking statements.

Factors that could cause the 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 annual report on Form 10-K filed for the year end December 31, 2021. The company cautions investors not to place undue reliance on the forward-looking statements made during the course of this conference call.

Willdan disclaims any obligation and does not undertake to update or revise any forward-looking statements made today. In addition to GAAP results, Willdan also provides non-GAAP financial measures that we believe enhance investors' ability to analyze the business trends and performance. Our non-GAAP measures include net revenue, adjusted EBITDA, and adjusted EPS.

I will now turn the call over to Tom Brisbin, Willdan's Chairman and CEO.

Thomas Brisbin, Chairman & CEO
Thanks, Al, and good afternoon, everyone. We believe 2022 was the end of the negative headwinds associated with COVID and the startup of the California IOU programs. As stated previously, we expected the second half of 2022 to show an upward trend, and it did. The results reported for the fourth quarter were net revenue up 25 percent, profit up 52 percent, organic growth up 25 percent. We have begun our trend back to a growth company that we were before COVID.

Let's first talk about why we are optimistic about 2023. For the first time since the 1970s, the U.S. federal government has passed legislation in energy to inject nearly $370 billion in the form of tax credits and loans to facilitate a faster clean energy transition via the Inflation Reduction Act. This will result in trillions of dollars of new clean energy investments over the next decade and will have a direct and longer lasting impact on our fundamental lines of businesses.

The beginning of this funding is supposed to hit the street sometime this quarter. To take full advantage of federal incentives, we are already consulting with utilities and cities on using these federal programs and are pivoting our utility programs to be able to stack federal and utility incentives together to make them more successful. Every state and utility are trying to maximize the amount of federal incentives for their customers.

We have a successful engineering and financial services practice focused on cities where we've seen a rapid growth in the number of cities that are also focused on maximizing their IRA benefit. We have a unique opportunity to bring our energy and infrastructure lines of business to benefit these customers. This natural synergy between our lines of business is all incremental to our base case forecast.

We are fortunate that we have been positioning for this clean energy economy transition for several years, and it appears that we were going in the right direction. There was an article about Willdan in Seeking Alpha a few days ago, and I thought the author was very accurate in the analogy. We did take deep setbacks in 2020, 2021, and 2022 and a stock loss greater than 50 percent of its market cap.

With the momentum from the fourth quarter and our backlog, the next three years look very exciting for Willdan. Let me give you a few examples of how we are positioned for this transition. The following example should demonstrate geography, capabilities, and experience.

Our E3 business, headquartered in San Francisco, continues to grow at 20 percent-plus. They provide high-end energy consulting to the entire country, helping develop their framework for the clean energy transition. They have been, and will continue to be, Willdan's light in the future on where we move for the continued growth of Willdan.

Our energy business in the West is significant because it is primarily in California, which is aggressive on clean energy. For example, we have held the contract with LADWP for 11 years and three recompetes. Serving the largest municipal utility in the nation is an excellent credential.

We also serve the four California IOUs in their quest to save energy and their transition to electrification. Specifically, we have amended the contract to allow us to continue with Southern California as we had mutually downsized the contract by 65 percent, or about $100 million per year, to reduce the risks for both of us. Through this amendment process, we have found a solution to the excessive ramp-up costs. It is fair to say that SCE's approach to contracting was not anticipated by Willdan. We did not know about the significant adjudicatory matter that they were dealing with in their energy efficiency programs.

That matter, which we were not a part of, has been settled, and we, together with SCE, are working on how to proceed with these programs, going forward. We believe that new management at SCE's energy efficiency (EE) group has the desire to save electricity and look to new ways to reduce carbon. The California IOU contracts are now expected to be positive contributors rather than negative drags.

With Pacific Gas & Electric, we are working on an all-new construction for the state and the public sector EE and electrification, energy efficiency, I should say, and electrification in their territory. For San Diego Gas & Electric, we were recently awarded an additional $11.6 million one-year contract to support small businesses statewide that are recovering from COVID. This is a customer service program where kWh delivery is not required. It is a professional services contract.

Our East Coast energy operations, New York, Maryland, Pennsylvania, Massachusetts, the Carolinas, are all well positioned for the next three to five years. For the first time ever in New York, most of the revenue is based on electrification measures, not energy efficiency. Lighting energy efficiency is now only 20 percent to 25 percent of revenue, down from 100 percent five years ago.

During the 2020 to 2022 tough times, we did a lot of rightsizing and positioning. Industrial energy efficiency, is positioned to be profitable, going forward, with private sector clients. Our New York energy engineering won significant work in 2022. With this group, we expect 50 percent organic growth in 2023. We have the work with the Dormitory Authority of the State of New York, the New York City Housing Authority (NYCHA), the New York Power Authority, and more. They have an excellent backlog and a plan for execution. Again, they are electrifying NYCHA housing as a way to decarbonize the grid and provide better living for the residents.

Our performance engineering is back on track for 2023 and some exciting news that we can share in the near future. In addition, we have won five performance engineering contracts in California, based on our relationships with the cities formed by our civil engineering group.

Our software business also came out of 2022 with a clear picture for 2023. Their pipeline looks good, and they will have news to share in the near future also, positive news, that is.

Our engineering and financial services for cities was Willdan's rock for 2022, just like E3. They grew, they were profitable, and we expect the same in 2023. We expect these city relationships to really help us with the clean energy transition and future investments by the government. Cities are an important customer for us and we have a 60-year-long relationship in California. We are seeing energy as one more professional service that municipal governments will be buying.

In summary, 2022 is behind us. We have solved the major issues and look forward to 2023. We are off to a good start based on the first two months of this year. I want to thank our employees for really doing a great job through some tough times. Willdan has become more resilient again. I would also like to thank our shareholders for their understanding and patience.

I will now turn the call over to Kim, who will provide additional details on our financial results and outlook.

Kim Early, CFO
Thanks, Tom, and good afternoon, everyone. Our Q4 performance reflected increasing momentum with gross revenue up by 23 percent and net revenue up 25 percent over the prior year. The numbers were driven by a surge in revenue under our California IOU programs as well as higher T&M revenues from energy planning services and our engineering consulting segment. Gross profit also increased 24 percent, consistent with the revenue growth, to $43.1 million for the quarter.

As a percentage of gross revenue, gross profit margin increased 40 basis points, reflecting the change in the mix of revenues. Our revenues and gross profits were up more than 20 percent. G&A expenses grew at a significantly lower rate than revenue. Lower stock-based compensation partially offset higher wages and salaries, while interest expense increased to $2.1 million for the quarter on the higher borrowing and higher average interest rates.

Our recorded pretax income for Q4 was $2.2 million, up 350 percent from $400,000 (sp) a year ago. The net loss of $425,000 in 2022 compared to a net loss of $890,000 for Q4 of 2021. Adjusted EBITDA was up 25 percent to $11.8 million for the quarter. Adjusted earnings per share was $0.36 compared to $0.47 in Q4 of 2021 due to the lower tax benefit and a higher diluted share count.

For the full year, gross revenue increased 21 percent and net revenue increased 12 percent. A significant increase in construction management activities was the primary factor behind the higher gross revenue and the differential in gross and net revenue growth rates. Such activities have a higher percentage of subcontracted services and material content, which lead to a much smaller net revenue increase. And 2022 also reflects higher revenues from engineering and consulting, partially offset by lower software licensing and direct install program revenue.

Gross profit in 2022 increased 6 percent to $143.6 million for the year, with gross margin decreasing to 33.5 percent from 38.4 percent in 2021, primarily due to the greater mix of the construction management business along with lower software licensing revenue and the ramp-up costs under the California IOU programs.

G&A costs increased a modest 4 percent year-over-year, again with lower stock compensation partially offsetting higher salaries and wages and higher computer-related expenses. Facility expenses have been reduced by 14 percent since the pandemic, or 21 percent on a per capita basis. Interest expense increased $1.4 million to $5.3 million for the year due to increased borrowing and higher average interest rates. While the pretax cost was reduced year-over-year by $952,000, even lower tax benefit resulted in the reported net loss for fiscal 2022 of $8.4 million, flat when compared to fiscal 2021.

2022's adjusted EBITDA was $23.3 million compared to $27.5 million a year ago. Adjusted earnings per share was $0.88 in fiscal 2022 compared to $1.55 in 2021.

From a balance sheet perspective, the $20 million drawdown of our term loan facility in Q1 financed a corresponding increase in the working capital over the course of the year to support the growth in revenue. Higher working capital levels resulting from the fourth quarter, 2022 surge in California IOU revenue will be converted to cash in the course of the first half of 2023 with a significant amount of this cash already received in Q1. Our unrestricted cash balance was $8.8 million at the end of 2022, down $2.4 million from a year ago, with nothing outstanding under our line of credit.

Looking ahead to fiscal 2023, we're expecting net revenue growth between 7 percent and 9 percent. We estimate our full-year effective tax rate will be approximately 27 percent and that the weighted average shares outstanding will be 13.7 million. Adjusted earnings per share is expected to be in the range of $1.24 to $1.32 and adjusted EBITDA in the range of $35 million to $39 million.

Consistent with the historic nature of our business in the calibrated earnings model, we expect the year to start with a seasonably lower Q1 and a peak in the third quarter as we continue to ramp up our utility programs and we expand construction management activities to coincide with school closings and warmer weather. The increased earnings and cash flow are expected to reduce our overall debt leverage below 2 times the adjusted EBITDA level, assuming no acquisitions during the year.

Operator, we are now prepared to answer questions.

QUESTION AND ANSWER SESSION

Operator
Thank you. We will now conduct a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. Once again, that's star, one at this time.

One moment while we poll for our first question. Our first question comes from Andrew Scutt with Roth. Please proceed.

Andrew Scutt, ROTH Capital
Good afternoon. It's Andrew on for Craig, and thank you for taking my questions. Just a quick one for me. You guys alluded to it in your comments. Could you just provide some more details on the analytics backlog? I know you guys have been optimistic of a few contracts being inked in the near future, but I understand it's a long sales cycle, so any additional color there would be great.

Michael Bieber, President
Sure, Andrew. This is Mike. We did not ink any of those deals in Q4, so the results were absent of new major software contracts. The pipeline of opportunities has never looked better. We submitted a number of proposals and are in a number of discussions with customers right now, and we're optimistic that we're going to have a very good first half of this year. Is that--.

Operator
--Our next question comes from Chip Moore with EF Hutton. Please proceed.

Chip Moore, EFHutton
Hey, good evening, everybody. Thanks for taking the question. A lot of great insight on some of the positive momentum you're seeing there in the prepared remarks. Again, about

guidance, maybe you can talk about visibility there. You touched on about sort of the progression moving through the year, but particularly as it relates to the California IOU programs, and particularly the SCE contract amendment. Help us with that. I guess that's my first.

Thomas Brisbin, CEO & Chairman
Hang on a second, Chip. We're trying to decide who should answer that question.

Chip Moore, EFHutton
Yeah, take your time.

Thomas Brisbin, CEO & Chairman
Get a little bit more specific on what you want to know about SCE's amendment and--.

Chip Moore, EFHutton
--Well, any more detail you can provide on it. But, really, what I was trying to get at was just around visibility on the guidance and conservatism, potential for upside. Yeah, you talked about the IA (sp) pipeline, I guess. For instance, what are you baking in on software deals, for example?

Michael Bieber, President
Yeah. Chip, this is Mike.

Chip Moore, EFHutton
Hey, Mike.

Michael Bieber, President
We have almost all of the work that we expect to contribute in 2023 either under contract or in firm backlog. It looks very good from that perspective. In addition, we continue to submit new proposals and see a number of new opportunities which might provide us upside if we're successful in winning those and starting to execute in the year. So, from that perspective, it looks very good coming into 2023. And we're carrying Q4's momentum into, as Tom mentioned, we've already seen it in the first couple months of this year.

So, from that perspective, it looks good. We have been, we've tried to factor down significantly any contribution from software in the year. We have, I won't say that we have completely factored it out, but we've been very conservative with our estimates on new software licenses to contribute to guidance. Having said that, the pipeline looks very strong for IA, and we're optimistic that even the first half of this year looks very good.

Chip Moore, EFHutton

Perfect. That's very helpful color, appreciate it, Mike. And then, I guess my other question is more on the civil engineering side. It's been, I think like you said, your rock, very resilient. Curious there, I guess two questions. First, any concerns on the broader macroenvironment?

And it seems like more, you're seeing more opportunity related to energy transition and IRA funding, so curious about what you're seeing there, sort of those synergies and any potential to maybe expand that business outside some of your traditional California markets, given those tailwinds over time.

Thomas Brisbin, CEO & Chairman
Yes, we have not seen the effect of whether or not we're in a recession or a recession is coming yet. We ask ourselves every day, what will 2023 be? As I said, we haven't seen it yet. To offset, though, we are thinking, just like you said, that this energy intersection of the cities and the IRA money and our lines of business, like with what E3 does, may, if we do see a recession, an effect on our civil engineering business may be offset by the ramp-up in energy. That's what we're talking amongst ourselves. That's about all I can tell you. I mean, if you're not known at this point. Anything else, Mike?

Chip Moore, EFHutton
Yeah. No, that's fair.

Michael Bieber, President
Counterintuitive, they had a very strong Q4 and are entering 2023, the first couple of months, better than ever. So, it has not translated into any slowdown at all right now.

Chip Moore, EFHutton
That's helpful. And maybe if I can sneak one last one, I think back to, as it relates to IRA, some of the tailwinds, I think you mentioned the growth you're seeing at E3 and how they're sort of your leading indicator on future direction. Just maybe expand on that and maybe where some of that direction might be.

Thomas Brisbin, CEO & Chairman
Well, this clean energy economy transition grid modification, whatever you want to call it, climate change, E3 is the leading, let's call it (inaudible) consulting firm probably in the nation. I mean, they are the ones that the states call and the utilities call. Where is the world going? How do I get there? And they are spending a lot on this electrification. We know we've got to reduce (inaudible) through EE, energy efficiency. We have to electrify.

They see this money as being enough, as you stack it on utility incentives and federal money, enough to get the market to move to a clean energy economy. Now, that is a 10-year deal. And where do we fit into that, and how do we capture that, is what we're working on. And we like where we are. I mean, we like working for the utilities, the private sector, the cities. And we have probably a deep understanding of where this transition is going because of what E3 does.

And I call it the practice we've been doing for the last six, seven, eight years. It's really gotten us a lot smarter. We understand the customers, what they need. And there's a lot of confusion in the market, what it means. I mean, they get called on by the vendors selling them something every minute on how to get better, cheaper, faster, less carbon. So, we're ready for it. I won't say completely ready, but we're in pretty good shape, so--

Chip Moore, EFHutton
--Yeah. No, pretty unique set of assets. Okay, I'll hop in. Thanks very much.

Operator
Once again, ladies and gentlemen, to ask a question, please star, one on your telephone keypad. Our next question comes from Marc Riddick with Sidoti. Please proceed.

Marc Riddick, Sidoti
Thank you, good evening. So, I was wondering if you could touch a little bit about the, what we should be thinking about, sort of how the amendment would, is there sort of any lumpiness into sort of where those changes would appear throughout the year as well as then, as a follow-up, I know that there had been the hiring ramp-up going into everything, which, most of which was done early in 2022. Should we be thinking about anything different as far as any headcount changes that may come from that? Or are you kind of where you need to be with the human capital there? Thank you.

Michael Bieber, President
Mark, the amendment has been signed. It's finalized with SCE. And there should be no lumpiness associated with it, actually. Just the opposite. It should remove the lumpiness out of those contracts, so pretty steady, slow ramp throughout the year on the California IOU work. Likewise, on hiring across the company, pretty slow, steady hiring throughout the year, not any major obstacle that we have to face in 2023.

Marc Riddick, Sidoti
Okay, great. And then, as far as the time frame as to maybe what you might be seeing as far as a pickup in some of the potential pipeline from the funding environment on state and local government levels, could you talk a little bit about, maybe is there a type of, are there any changes in the types of projects that you're seeing? Or are there any particular ones that are kind of at the forefront of picking up demand relatively sooner rather than later relative to some of the other services that you may provide? Thank you.

Michael Bieber, President
On the state and local, what we've actually seen is a lot of energy efficiency work for state and local governments. We did that work in our performance engineering group, and they're

entering this year with record backlog and a lot of momentum with cities that are trying to invest in upgraded infrastructure and energy efficiency.

The IRA money, we think, will be a future catalyst to that group of customers, but we haven't actually received a contract that is funded by IRA money. That is future growth opportunity for us right now. We had a number of discussions with customers trying to figure out how to access that money and best put it to use. But, that is not what we're currently seeing right now. It's a future opportunity for us in 2023.

Marc Riddick, Sidoti
Great. And then, one last thing for me. I was sort of curious as to whether or not, and this may be a little squishy, so forgive me, but I was sort of curious as to whether or not you've seen any weather impacts on the business. I know we've seen some historical weather challenges. I wasn't sure if that was anything that would have had any impact on maybe what you've seen, at least through the, at the end of last year and maybe through the beginning of this year, what some of the (inaudible) that we've seen this year. Thanks.

Thomas Brisbin, CEO & Chairman
Some of our people who go skiing a lot can't get into the resorts, but--.

Michael Bieber, President
There have been no impacts from weather.

Marc Riddick, Sidoti
Thank you very much.

Operator
Thank you. At this time, I would like to turn the call back to Tom Brisbin for closing comments.

Thomas Brisbin, CEO & Chairman
I'd just like to thank everybody for tuning in. And we expect good results in the first quarter, and we'll see you in about 90 days.

Operator
Thank you.

Thomas Brisbin, CEO & Chairman
All right. Thanks a lot, everyone.

Operator
Thank you. This does conclude today's teleconference. You may disconnect your lines at this time. And thank you for your participation, and have a great day.