WILLDAN GROUP, INC.

Second Quarter Fiscal Year 2022 Conference Call

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(edited)

CALL PARTICIPANTS

EXECUTIVES – WILLDAN GROUP

Al Kaschalk – VP Investor Relations
Tom Brisbin – CEO & Chairman
Kim Early – CFO
Mike Bieber – President

ANALYSTS / INVESTORS

Chip Moore – EFHutton
Marc Riddick – Sidoti & Company

PRESENTATION:

Jenny, Operator

Good day, and welcome to the Willdan Group Second Quarter Fiscal Year 2022 Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Al Kaschalk, VP, Investor Relations. Please go ahead, sir.

Al Kaschalk, VP Investor Relations

Thank you, Jenny. Good afternoon, everyone. And welcome to Willdan Group's Second Quarter Fiscal 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 Beaver, President. The call today builds on our earnings release we issued after market closed today.

You may find the earnings release, and the Willdan Investor Report that accompanies today's call in the Press Release and Stock Information section of our Investor Relations website found at ir.willdan.com. Management will review prepared remarks. And then, we'll open the call up to your questions.

Statements made in the course of today's conference call, including answers to your questions 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 Annual Report on Form 10-K filed for the year ended December 31st, 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 the investor's ability to analyze the business trends and performance. Our non-GAAP measures include net revenue, adjusted EBITDA, and adjusted EPS.

Tom, I will turn the call over to you.

Tom Brisbin, Chief Executive Officer

Thanks, Al. And good afternoon, everyone. The second quarter did not meet our expectations. We have hit some headwinds. First, the California IOU programs, which we will discuss. Second, we are also, faced with some timing issues on software license sales. Also, COVID supply chain has slowed some contracts.

Given these headwinds, the quarter was weak. We expect to turn the corner significantly in the second half. In the second quarter, we made significant progress in streamlining the delivery of energy efficiency under these new IOU programs. We reduced the amount of effort that it takes to receive a pre-installation package approval.

This major change will reduce our engineering efforts significantly, and reduce the timetable for delivering projects by two to three months. We successfully work with PG&E to enhance the technical support we provide to architects and building developers throughout California. We also, streamlined our contract delivery requirements.

We successfully worked with SDG&E to improve delivery of energy efficiency to small businesses through enhanced co-payments to these economically-sensitive customers. These are first-of-a-kind programs with brand new processes and requirements. Our IOU customers are learning with us.

This learning curve has resulted in a slower ramp up, but the changes we and the IOUs are now making will result in a much better performance of these programs. For the first time in 18 months, we're delivering projects that will significantly increase revenue. Organic growth has improved from 2% to 5% to 12% over the last three quarters.

Given what I just said, there are likely concerns out there. But here's the way we see the rest of the year. We expect revenue and profit to significantly ramp in the second half. We are now making progress in California. Our engineering, financial, and energy consulting are all doing extremely well. Our New York City Housing Authority, NYCHA, and our Los Angeles Department of Water and Power, LADWP programs are also, doing well.

We only have the California IOUs to turn in the third quarter and ramp heavily in the fourth quarter. Going forward into 2023, we expect the headwinds to moderate. And we will see significant organic growth in revenue and profit. It has been a tough 12 months. But we are making progress.

Personally, my confidence has increased significantly because we and our customers are working more closely together.

I would now like to turn the call over to Kim for our financial discussion.

Kim Early, Chief Financial Officer
Thanks, Tom. And good afternoon, everyone. Gross revenue for the second quarter increased by 22% over the prior year to $102.6 million. While net revenue net of subcontractors, materials, and other direct costs increased 11.9% to $52.9 million for the quarter. The increased revenue was derived primarily from the resumption of the LADWP program, and increased construction management revenues.

Gross profit for the quarter was $31.6 million or 30.8% of revenue compared to $30.9 million or 36.7% of revenue a year ago. The lower gross profit margin was primarily due to the higher mix of construction management revenues, lower software revenues, and higher ramp-up costs for new programs in the current year quarter.

G&A costs for the quarter were $36.9 million for Q2 of 2022 or 2.8% lower than a year ago. Lower stock compensation expense more than offset higher salaries and higher professional service and computer-related expenses. Interest expense was slightly lower than a year ago due to lower average interest rates derived from the expiration of a three-year old interest rate hedge.

The loss before income taxes improved to $5.9 million versus the $8.3 million pre-tax loss in Q2 of 2021. The income tax benefit for the current quarter was $1.7 million compared to a tax benefit of $3.7 million in 2021. The smaller pre-tax loss and the absence of a one-time CARES Act benefit realized in 2021 resulted in a lower income tax benefit for 2022.

The net loss of $4.3 million for Q2 of 2022 was improved from a net loss of $4.6 million reported for Q2 of 2021. Adjusted EBITDA was $1.2 million for the quarter compared to $3.3 million a year ago, reflecting the change in the mix of revenues combined with higher costs versus revenue recognized related to the new California IOU programs.

Our adjusted loss was $0.06 per share for Q2 of 2022 compared to adjusted earnings of $0.24 per share in 2021. For the six months, gross revenue increased 19.1% to $194.5 million, while net revenue increased 8.2% to $103 million. The net loss for the first six months of 2022 was $8.1 million compared to $8.4 million for the same period of 2021.

Adjusted EBITDA was $3.5 million versus $8 million in 2021. Adjusted earnings per share was $0.02 per share for the current year to date compared to $0.43 a share a year ago. On the balance sheet, the reduction in receivable since yearend primarily reflects the collection of pass-through incentives from various utilities which were paid to utility customers under energy efficiency programs, and accounts for the bulk of the corresponding reduction in accounts payable over the same period.

The liability side of the balance sheet also, reflects the payment of contingent consideration earned by prior acquisitions and the drawdown of the remaining delayed drawn term loan in the first quarter of this year. Cash used by operations was $3.6 million for the year-to-date 2022 compared to cash used of $708,000 in 2021.

Capital expenditures were $4.3 million for the first half of 2022 primarily for internal software development. Scheduled principal payments on our term loans and earnout payments resulting from the successful acquisition performance were offset by a $20 million drawdown of the delayed drawn term loan resulting in cash provided by financing activities of $2.4 million for the period compared to cash used of $15.2 million in 2021.

Looking ahead to the remainder of fiscal 2022, we have adjusted our expectations for financial performance. Our new guidance calls for a minimum net revenue growth of 10% over 2021 with a minimum adjusted EBITDA margin of 10% of net revenue. Operator, we're now prepared to answer questions.

QUESTION AND ANSWER

Jenny, Operator

Thank you. If you would like to ask a question, please signal by pressing star one 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 one to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions. And we will go first to Chip Moore with EF Hutton.

Chip Moore, EFHutton

Good evening. Thanks for taking the questions. I wonder if we could start with the California IOUs. You were talking about I think $50 million or so, this year, and the most of that in the back half. So, maybe we start with that is where do we see that? And then Tom, you talked about some streamlining efforts. What are the implications there? Maybe you could talk a bit more about what you're doing? When we think about next year, how should be thinking about that ramp up with some of these efforts?

Tom Brisbin, Willdan Group

Mike has been dealing with this day to day. He's no longer – well, he is still the President, but he thinks he's a project manager right now because he is into it thick. And with regards to the 50 streamlining and the third part was --

Chip Moore, EFHutton

Going into next year.

Mike Bieber, President

Going into next year.

Chip Moore, EFHutton

Yeah, yeah. Do we still think 150 to 200 contract revenue next year with some of these efforts? Yeah.

Tom Brisbin, Willdan Group

All right. Mike's going to handle this one.

Mike Bieber, President

It'll likely be less than 50. And I think we said that last quarter, Chip also. I don't think it'll come into 50. It'll be less than that this year. It'll still be likely a big number for next year. I don't know, whether it's 150. That's a reasonable estimate I think. It could be below or even above that number for next year.

So, it'll be a big ramp up. A lot of this year, the revenue you'll start seeing for the first time actually, you'll start seeing that revenue come in the third quarter of this year. Because as Tom mentioned in his script for the first time now in 18 months, we're building projects out and completing them. So, you'll see the result of that start in Q3. It'll ramp up in Q4, and then, throughout the first part of 2023.

Chip Moore, EFHutton
Got it. Okay.

Tom Brisbin, Willdan Group
Streamlined in next year. Hang on a second, Chip.

Chip Moore, EFHutton
Yeah, go ahead.

Tom Brisbin, Willdan Group
Streamlining?

Mike Bieber, President
Do you have any specific questions about streamlining or the processes that we mentioned that we've been working on with our customers?

Chip Moore, EFHutton
Yeah. Maybe if you could just give us a little more detail on how that'll benefit you. You talked about the learning curve. These are new programs. So, just how that process plays out, and some of the benefits of some of these actions?

Mike Bieber, President
We've been in this now for nine months or so. And we have discovered certain things that don't work in the program, don't work for us, and don't work for the IOUs actually. And in every case, with each of the three major IOUs we've started with, this quarter we've made major modifications in the process necessary to deliver these projects. Tom mentioned a few of them. There's a bunch more actually that we've worked on. And it's those process changes that are going to streamline the delivery of energy efficiencies in the State of California. So, you'll start to see that. Many of these changes have already been made. A few of them, we're still in discussions to make. But I would say the majority of them have been made at this point. And you'll see that reflected in the financial results.

Chip Moore, EFHutton
Okay, got it. That's helpful. And maybe on guidance, talking about minimum figures. It sounds like there's some conservatism baked in. And you did call out software timing of potential issues. So, maybe two questions there, but just conservatism on that 10%. And then IA licensing deals, did something slip or do you have visibility there? It sounds like the pipeline is still strong, but any insights there?

Mike Bieber, President
So, for guidance, we hate disappointing. Yeah, we've tried to build in some conservatism there. And that's why we first set a floor for ourselves. We set at least these minimum. So, that's how we approach the guidance. We look to better that.

On Integral Analytics and Software, we have a very good pipeline of opportunities. We have not signed what I'll call a major software license in the first half of the year, however. And as you know, Chip, when those things hit, they drop significant profit to the bottom line. So, that has not occurred in the first half of this year. We thought, there's a good probability of that. It has not happened thus far. But we're still I think as confident as ever. We've got a very good pipeline and some large license opportunities out there, so.

Chip Moore, EFHutton
Got it. I guess my question is really back to being conservative. What's baked in on the software side and the back half?

Mike Bieber, President
On those floors, not much, I can tell you that. But we don't expect to deliver that. We expect to deliver some good news here in the back half of the year. As you know, those things are very lumpy. When they come, they come in big chunks. So, we just didn't want to pin ourselves down. We said the back half of the year. In terms of timing, I think that's reasonable. But we essentially assumed no incremental software licenses to get to the floors that we mentioned in our guidance.

Chip Moore, EFHutton
That's what I was getting at. So, that would be a nice upside boost if one of those cross the finish line? Okay. And then just elsewhere, you called out some of the supply chain issues slowing some things. Any more color there on just the size of that impact? And things are getting better currently or visibility?

Mike Bieber, President
Supply chain is affecting us like everyone in this space that orders big custom equipment for buildings. But that was much less of a headwind than California that we mentioned before in the script. I want to place caution on that. We had planned for some of that delay, some of the supply chain delays. We saw that. We expect that continue to be a headwind for some time. And it's in projects that require large custom-built equipment, HVAC chillers, boilers, that kind of thing. The average delay is significant for those big pieces of equipment, the Genesys and other of our units use. So, those were the delays. You can see that revenue was still pretty good for the quarter. We're still expecting that to be the case. And that's reflective of the fact that we had planned for some of those delays.

Chip Moore, EFHutton
Yeah, okay. All right, I'll hop back in the queue here. Thanks.

Jenny, Operator
And as a reminder, it is star one if you would like to ask a question at this time. We'll pause for a moment. And we will go next to Marc Riddick with Sidoti.

Marc Riddick, Sidoti
A very good evening. So, I wanted to piggyback on the end of that comment because it seemed as though the net revenue was fairly similar to what we were expecting I guess for the second quarter itself. And so, it does somewhat indicate consistently in your prepared remarks that outside of what you're going through with the IOU execution, it sounds like the rest of the business, it seems though is humming along pretty nicely. So, maybe could we spend a couple

of minutes on what you're seeing with LADWP and other areas? And maybe some of the demand that you're seeing outside of that?

Mike Bieber, President
Tom's pointing at me. The strongest areas of our business are civil engineering, the energy consulting business, and the financial services business. All three of those are well ahead of our internal plan. They're doing very good. All three are showing strong profitability and growing organically. So, those are the strongest parts of the business. Then you move into other sectors of our energy portfolio. Yeah, LADWP is doing all right. It's a good piece. Most of the other programs are doing pretty well. Small businesses are sometimes a little challenged in some places. But you're right that any challenges we see are being offset by the upside we're seeing in civil engineering and energy consulting. So, that's why you saw the revenue come in reasonably strong.

Marc Riddick, Sidoti
Right. And then, I wanted to touch a little bit about working with the IOUs there. It didn't seem as though from your remarks that it was necessarily tied to additional talent or headcount or anything like that. Am I reading that correctly? Or can you give us an update there as to where you are with hiring or human capital, and where you may need to be or if that's changed at all?

Mike Bieber, President
Yeah, Marc. No issues with human capital, no disagreements there or anything else. Those comments were around the idea that when we started these programs, we didn't know our customer nearly as well as we do today. We acted more, I won't say adversarially. We just didn't know one another, and hadn't worked together on these types of programs. And in every case, now, I think the big change in the quarter has been that in each of these programs, we're sitting side by side, day by day now making the changes that we've needed to make to these programs to make them successful and more efficient. So, that was the big change that we tried to convey in the quarter. We're working very well actually with each of the IOUs. It's not adversarial. We're on the same page driving to the same goals to make these programs successful. We just need to make some changes. And they're more than willing, they're facilitating those changes with us. So, that's where we are.

Marc Riddick, Sidoti
Okay, excellent. And then, I guess, the last thing for me. I was thinking about the -- you made mention as to as far as ramping into the third quarter or what have you, are there any particular signposts that you're looking at as you go through the quarter? Or are there any particular lumpiness? I don't need you to get necessarily too, too granular. But I was thinking about maybe how you see that play out and what level of visibility you may have through the remainder of the year? Thanks.

Mike Bieber, President
Signposts for Q3. Well, we have begun just California IOUs first. We have begun building projects now for the first time on those programs. The waiting has stopped. And so, we're going to see that month by month ramp up. We do have good visibility on that. The real question becomes now. Now that we're building projects, how quickly will it ramp from there? So, there's a lot of visibility in Q3, less visibility in Q4. The pipeline of sales is ramping up that would contribute to those quick turn projects towards the end of the year. So, that's where the question is more, more Q4 than Q3. So, we'll see internal signposts of that as we build projects each month, and actually see revenue drop to the bottom line for the first time.

The other is of course software. And that disproportionately affects our profitability. We are optimistic. We have some things that we think are pretty close, but those aren't signed to tell they're signed. So, I don't want to be too speculative on that. And we've as we said removed those from guidance. If they happen, we'll certainly let you know. And you might see press releases to that effect.

Marc Riddick, Sidoti
Okay, great. And the last piece from me is that it seems as though there's a little bit of an amendment on the credit agreement recently. And I wonder, if you could just touch a little bit about that? It certainly seems as though from a funding environment standpoint, you're where you need to be. But I was just wondering if you could give us a little bit of an update there? Thank you.

Kim Early, Chief Financial Officer
Yeah, Marc. This is Kim. That amendment primarily just gave us more room to on our capital leases. We use capital leases primarily for some of our computer-related equipment and software. And our agreement had a $1.5 million limit on that. We raised that limit just to give us more room on the capacity that we could use third-party financing for those capital leases instead of running it through our banking agreement. So, that's what that amendment had to do with. It's all in place.

Marc Riddick, Sidoti
Okay, great. Thank you very much.

Jenny, Operator
And with no further questions in the queue, I would now like to turn the call over to Tom Brisbin for closing remarks.

Tom Brisbin, Willdan Group
Well, I'd like to say thank you to everyone who's on the call today. And we look forward to seeing you next quarter. Have a good day.

Jenny, Operator
And so, this concludes today's call. Thank you for your participation. You may now disconnect.