Company: **WILLDAN GROUP, INC.**

Conference Title: **Willdan Group Fourth Quarter 2017 Conference Call**

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Moderator: **Tony Rossi**

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Operator: Good day everyone and welcome to the Willdan Group Fourth Quarter 2017 conference call.

Today's call is being recorded.

At this time, I would like to turn the call over to Tony Rossi. Please go ahead.

Tony Rossi: Thank you. Good afternoon everyone and thank you for joining us to discuss Willdan Group's financial results for the Fourth Quarter ended December 29, 2017.

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.

Management will review prepared remarks and we will then open up the call to your questions.

Statements made in the course of today's conference call, which are not purely historical, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements involve certain risks and uncertainties. And it is important to note that the company's future results could differ materially from those in any such forward-looking statements.

Factors that could cause actual results to differ materially and other risk factors are listed from time-to-time in the company's SEC Reports including but not limited to the Form 10-K for the year ended December 29, 2017.

The company cautions investors not to place undue reliance on the forward-looking statements made during the course of this conference call. Willdan Group disclaims any obligation and does not undertake to update or revise any forward-looking statements made today.

In addition to GAAP financial results, Willdan also provides non-GAAP financial measures that we believe enhance investors' ability to analyse our business trends and performance.

Our non-GAAP measures include revenue net of subcontractor services and other direct costs and adjusted 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.

Adjusted EBITDA is a supplemental measure of operating performance, which removes the impact of certain expense items from our operating results. GAAP reconciliations for both of these non-GAAP measures are included at the end of the Earnings Release we issued today.

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

Stacy McLaughlin: Thanks Tony. I'd like to add my welcome to those joining us on today's call. I'll start with an overview of our income statement, then our balance sheet and finally our margin trends.

Total contract revenue for the Fourth Quarter of 2017 increased 11.7% to $64.2 million from $57.4 million for the Fourth Quarter of 2016.

By segment including both organic and inquisitive revenue for the fourth quarter, Energy Efficiency Services revenue increased 19.4% to $45.7 million. Engineering Services Contract revenue declined 9.4% to $14 million. Revenue from Public Finance Services increased 4.9% to $3.3 million, and Homeland Security Services revenue increased 124% to $1.1 million in the quarter.

Willdan intends to collapse its segments in 2018 from four segments to two segments by combining its three non-energy segments into one.

Our fourth quarter total contract revenue included incremental revenue of approximately $600,000 attributable to the acquisition of Integral Analytics, which is included in our Energy Efficiency Services segment.

The organic growth rate was 6% for the prior year period. Net revenue defined as contract revenue minus subcontractor services and other direct costs was $31.1 million, an increase of 9.8% from $28.4 million in the year ago quarter.

Direct costs of contract revenue were $44.2 million for the Fourth Quarter of 2017, an increase of 12.3% from $39.3 million in the same period last year. The increase is 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 68.9% of our total contract revenue in the Fourth Quarter of 2017, down from 70.6% in the Third Quarter of 2017. The decline was due to lower subcontractor services and other direct costs, which represented 51.5% of total contract revenue this quarter, down from 54.1% in the prior quarter.

As we said earlier in the year, we believe our direct costs as a percentage of contract revenue peaked in the Second Quarter of Fiscal 2017. And we have subsequently seen two quarters of progressively lower costs, which has positively impacted our margin.

General and administrative expenses for the fourth quarter were $17 million compared to $15.4 million for the prior year period. As a percentage of total contract revenue, our G&A expenses were 26.5% relatively consistent with the 26.8% we had in the Fourth Quarter of 2016.

Operating income was $3 million for the Fourth Quarter of 2017, an increase of 11.3% over $2.7 million generated in the Fourth Quarter of 2016.

Adjusted EBITDA defined as EBITDA before noncash stock expense was $5.3 million for the Fourth Quarter of 2017 compared with $4.3 million for the Fourth Quarter of 2016. Adjusted EBITDA as a percentage of net revenue for the Fourth Quarter was 17% up from 15% compared to the prior year period.

During the fourth quarter, we recorded an income tax benefit of $277,000. This was attributable to the impact of the Tax Act passed into law in December, which allowed for the re-measurement of our deferred tax assets and liabilities and resulted in a one-time decrease in our deferred tax expense of $1.3 million or 14 cents. Without this one-time benefit, our diluted EPS would have been 22 cents compared to 18 cents in the prior year.

In 2018, we expect to have a tax benefit of approximately 10 cents per share related to a 179D Energy Efficiency Tax deduction, which was recently passed. We estimate our tax rate to be approximately 23% for 2018. However, we estimate our long-term tax rate to be approximately 28%.

Net income for the Fourth Quarter of 2017 was $3.3 million or 36 cents per diluted share compared to net income of $1.6 million or 18 cents per diluted share for the Fourth Quarter of 2016.

Turning to the balance sheet, we had $14.4 million in cash and cash equivalents at December 29, 2017, which was a decrease of $8.2 million since the end of the previous fiscal year. The decrease was primarily driven by the use of cash for the acquisition of Integral Analytics, payments for contingent consideration and notes payable related to our prior acquisitions. This was partially offset by cash generated from operations.

Our DSO was 75 days at December 29th. Although this was an increase from 65 days at yearend 2016, we had a strong quarter of collection, which increased our cash balance by $8.8 million from the end of the third quarter.

As of December 29, 2017, we had approximately $2.5 million in outstanding borrowings under our revolving line of credit and no loans outstanding under the term loan facility.

Before I turn the call over to Tom, I want to address adjusted EBITDA margin for the year defined as EBITDA before noncash stock compensation expense divided by net revenue.

We are pleased that adjusted EBITDA margin for 2017 was 18% up from 15.7% in 2016. We expect our adjusted EBITDA margin to continue to improve up to around 19% for 2018.

I'd now like to turn the call over to Tom.

Thomas Brisbin: Thanks Stacy and good afternoon everyone. We finished 2017 with another good quarter. Through both organic business development and our acquisition activity, we continue to increase the overall diversification of the company and our revenue mix.

In 2017, we worked in more states for more clients on a greater number of project types than at any point in our history. Comparing our fourth quarter results to the fourth quarter of last year, we grew revenue 12% against a tough comp and we more than doubled our net income.

We saw higher revenue coming from newer programs in New Jersey and Illinois and a ramp up of our Local Capacity Requirements contract or LCR for San Diego Gas and Electric.

We've gotten off to an excellent start on the LCR Program. Our goal was to deliver 1 Megawatt of energy savings in 2017 and we delivered 1.4. The contribution from the LCR Program is expected to take another step up in 2018 where we are scheduled to deliver 4 Megawatts of capacity.

We believe we are well-positioned for another positive year in 2018. All of our major energy efficiency programs for utilities will continue throughout 2018 and beyond, which gives us a strong foundation for layering on incremental growth.

Our acquisition pipeline looks good and we expect continuous strategic acquisitions in 2018.

To this foundation, we expect to see additional contributions from as we said the LCR Program. We see growth in our relationship with ComEd in Illinois. We had a recent announcement of the expansion of our Data Center Program and a new award we received for a Public Sector Program.

The ramp up of our new Small Business Direct Install Program for Potomac Edison in Maryland, our work in New Jersey will grow because of the addition of programs targeting the public sector and schools.

Contract for Department of General Services, which is $120 million over 5 years, is just getting started. We have our first two assignments.

Southern California Edison will be expanding its program targeting schools. And SoCalGas will be starting programs for gas measures targeting schools and lodging.

It's very nice that all our programs are extended or ramping up. New types of opportunities such as local capacity, non-wires, non-pipes, are indicative of a changing landscape.

For Willdan, we are very proud that we are winning the new opportunities. Our mechanical, electrical engineering focus of 360/Abacus and Genesys also are proving invaluable for cross selling these new opportunities. They are performing exceptionally well in their local and state markets and giving us a competitive advantage for the new opportunities.

From a business development perspective, a primary focus in 2018 is capitalizing on the mandate to increase the amount of energy efficiency outsourcing by California investor owned utilities. We believe we will see RFPs later in 2018. Well noted this has been a moving target and a little later than initially projected.

We know the increase in outsourcing in California will be a multiyear catalyst for future growth at Willdan. That the percentage of outsourced programs for the California IOUs must increase from 20% to at least 25% by the end of 2018, increase to at least 40% by the end of 2020 and increase to at least 60% by the end of 2022.

From a longer-term perspective, we are successfully building Willdan into a company that is at the forefront of the electric grid. We expect to see a significant increase in revenue for Integral Analytics, our most recent acquisition. IA, Integral Analytics has been selected to modernize the planning and operations of Hawaiian Electric. This is significant because of the rapid increase in renewable generation, nearly 100%, in Hawaii.

PG&E has also adopted IA software because of the increased solar adoption. We see this trend growing. With the powerful data analytic capabilities that we can now integrate into energy efficiency projects, we are evolving Willdan from a services company into a solutions company. A company that solves problems for a diverse range of clients by leveraging both people and software, a company that is a leader in both electric grid transformation and Smart Cities where we help our clients collect and analyse data in order to manage their assets and resources more efficiently.

We have had a good month for Smart Cities. As you'll recall, we worked on nine New York Microgrid Feasibility Studies. We have just been selected for the $18 million California Energy Commission Grant for the San Jose Community Microgrid. This is in addition to the Air Quality Management District CEC Award we are working on now.

We also won the Massachusetts competition for the Wentworth Institute of Technology Microgrid and a contract to be a technical advisor to the state for Microgrids.

The Illinois Commerce Commission just approved the Bronzeville Microgrid. This microgrid will be a first of its kind for the country linking the Illinois Institute of Technology Campus to Bronzeville. We are currently working on the 8 Megawatt CHP facility at IIT to determine its feasibility as a source of distributed generation for both microgrids.

We were also awarded a U.S. TDA, that's Trade Development Agency project for a university campus in Ankara, Turkey. We also have pending microgrid opportunities for the DOD and Indian Tribes within California.

Our 50 year-old, changing subjects a little bit, 50 year-old Civil Engineering Practice for California cities did very well also. We're especially proud to see their expansion into ten new cities in Northern

California. California is still growing and we are seeing more integration with our energy services on Smart Cities. Our financial consultancy also did well.

To assist with our continued evolution we have announced a number of changes in our senior management and Board of Directors. As part of our succession planning, Micah Chen, our General Counsel, and Paul Whitelaw, our Head of Business Development, have been named as Executive Officers of the company.

At the Board level, we are pleased to welcome Debra Coy. Ms. Coy brings an investor perspective to our Board. Her 20 plus years guiding investors in the water utility market is impressive. Her experience with regulated utilities and public policy will help guide our strategies.

And finally, Win Westfall will be retiring from the Board. Win has served on our Board since 2006 and was our Chairman for approximately ten years. We are greatly appreciative of Win's years of service for the company and the valuable input he provided as we transformed Willdan's business model over the past decade. We wish him all the best in his retirement.

Now let me discuss some trends that have led us to change the metrics we are guiding to in 2018.

Over the last several quarters, we have increasingly talked about net revenue defined as revenue net of subcontractor and other direct costs. Because subcontractor costs are mostly equipment pass through that has low or no margin on the revenue, in some cases especially on the East and West Coast we have been successful in renegotiating some contracts, are changing our execution model to reduce this pass through equipment cost.

Accordingly, we are now guiding investors to a net revenue range instead of gross revenue. Last year, our GAAP EPS included about 27 cents of noncash stock compensation expense. Without noncash stock comp expense, our 2017 diluted EPS would have been $1.59. In 2018, we expect noncash stock comp expense to rise to around 35 cents per share. The 2018 increase in stock compensation will closely align Management's goals with the shareholders.

We have looked at our peer companies and many other rapid growth, smaller public technology oriented companies and noted that they present EPS metrics both before and after noncash stock expense. Accordingly, we have begun disclosing both numbers and are now guiding investors to and EPS range before noncash stock comp expense.

To our guidance, in 2018, we expect net revenue to range between $130 million and $140 million. This represents an approximate 7% to 15% growth over last year not including any future acquisitions. Also in 2018, we expect diluted earnings per share before stock compensation expense to range between $1.95 and $2.05 per share. This represents an approximate 21% to 29% earnings growth over last year both before and after stock comp.

Looking at a few assumptions, we expect stock comp expense net of tax benefit to be approximately 35 cents per share. Depreciation is expected to be approximately $2 million. Amortization is expected to be approximately $3 million. The effective tax rate is expected to be approximately 23%. Diluted share count is expected to be $9.3 million. No future acquisitions are included in guidance.

With that, I would now like to turn call back to the Operator for Q&A.

Operator: Thank you. If you would like to ask a question, please press star 1 on your telephone keypad. If you're using a speakerphone, you may need to pick up the handset before pressing the corresponding digits. Once again, please press star 1 at this time if you'd like to ask a question.

We'll take our first question from Ariel Hughes with Wedbush.

Ariel Hughes: Hi, good quarter so just wanted to follow-up.

Thomas Brisbin: Ariel we can hardly hear you.

Ariel Hughes: Hi. Can you hear me?

Thomas Brisbin: Yes.

Ariel Hughes: All right, just wanted to follow-up on the Integral Analytics acquisition just hoping if you guys can provide some details on, you know, how clients are receiving the new offering, how you guys are advancing on cross selling opportunities and perhaps how that might affect margins moving forward.

Mike Bieber: We're very pleased with Integral Analytics. This is Mike. They've done very well out of the gate. They both helped us win new cross-selling opportunities, for instance they went to orals with us on the ComEd competitions that we won earlier in the year.

And also they've done well on their own. They've been selling software, planning software to HECO and other utilities.

So out of the gate, they've been doing well. That's why we expect, you know, 9, $10 million of revenue in 2018.

And you're right, they will also improve -- help to improve -- Willdan's operating margin.

Ariel Hughes: Thank you. That's it for me.

Operator: And as a reminder, it's star 1 if you would like to ask a question.

Thomas Brisbin: We see no further questions.

Operator: With no further questions, I would like to turn the call back over to management for any additional or closing remarks.

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

Operator: And this does conclude today's conference. We thank you for your participation. You may now disconnect.