Company: **WILLDAN GROUP, INC.**

Conference Title: **Willdan Group Second Quarter 2019 Conference Call**

Conference ID: **5428448-1-0**

Moderator: **Tony Rossi**

Date: **August 1, 2019**

Operator: Good day, and welcome to the Willdan Group Second Quarter 2019 conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Tony Rossi of 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 second quarter ended June 28, 2019. 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'll then open up the call to your questions.

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

Factors that could cause actual results to differ materially and other risk factors are listed from time to time in the company's SEC reports, including but not limited to, the Form 10-K for the year ended December 28th, 2018, 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 investors' 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'd now like to call -- turn the call over to Chief Financial Officer, Stacy McLaughlin. Stacy?

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

Total contract revenue for the second quarter of 2019 increased 75% to $104.4 million from $59.8 million for the second quarter of 2018. The increase was driven by growth in our Energy segment, primarily related to the contributions from our recent acquisitions. Net revenue defined as contract revenue minus subcontractor services and other direct costs was $46.8 million, an increase of 36% from $34.3 million in the year ago quarter.

Within the Energy segment, net revenue increased by 60%. Within the Engineering and Consulting segment, net revenue increased by 2%. Direct costs of contract revenue were $73.2 million for the second quarter of 2019, an increase of 100%, from $36.7 million in the same period last year.

The increase was primarily related to the growth in contract revenue resulting from the recent acquisition. Additionally, we had disproportionately high project start-up costs compared to the revenue we recognized on those programs.

Our direct costs of contracts revenue were 70% of our total contract revenue in the second quarter of 2019 compared with 61% in the same period of the prior year. The increase was primarily attributable to the impact of our recent acquisitions, which has programs that utilize a higher percentage of subcontractors and included significant amount of material and equipment costs that are passed through.

General and administrative expenses for the second quarter were $28.4 million compared to $19 million for the prior year period. The increase was primarily driven by higher salaries and wages related to the personnel added through the last three acquisitions and the investment we are making in the California investor owned utility procurements.

The California proposal investment we made this quarter was approximately $2 million. The remainder of the increase was primarily due to $1.8 million increase in depreciation and amortization expense, largely due to the increase in intangible assets resulting from our acquisition. We also had an increase in stock-based compensation expense of approximately $600,000.

Our second quarter results in 2019 include approximately $340,000 in acquisition costs. We generated operating income of $2.8 million for the second quarter of 2019 compared to operating income of $4.2 million in the second quarter of 2018. We incurred $1.2 million in interest expense in the second quarter of 2019 compared to $30,000 in the same period last year. The increase was due to the debt utilized to finance our recent acquisition.

During the second quarter, we recorded an income tax benefit of approximately $70,000, primarily attributable to various tax deductions and tax credits. Net income for the second quarter of 2019 was $1.6 million or 14 cents per diluted share, compared with net income of $3.3 million or 36 cents per diluted share in the same period last year.

On an adjusted basis, excluding stock-based compensation, intangible amortization and transaction costs, our net income was $5 million or 43 cents per diluted share. Adjusted EBITDA was $7.6 million for the second quarter of 2019, compared with $7.3 million for the second quarter of 2018.

Turning to the balance sheet. We had $27.6 million in cash and cash equivalents at June 28, 2019, which was up from the end of the previous fiscal year or quarter, excuse me. Our cash flow from operations was $12.5 million in the first six months of the year. As of June 28, 2019, we had $100 million term loan outstanding, but no amounts outstanding on our revolving credit facility or our delayed draw term loans.

In the back half of the year, we expect revenue to accelerate and organic growth to increase due to work that we have already booked. This year we will have increased funding from each of our four largest clients, Los Angeles Department of Water and Power, Con Edison, Duke Energy and the Dormitory Authority of the State of New York that will drive the ramp in the back half of the year. We expect margins to rise significantly compared to the first half of the year.

Turning to our outlook. I would like to update our financial targets for fiscal 2019. For the full year, we now expect net revenue to range between $185 million and $205 million; adjusted diluted EPS to range between $2.40 and $2.50; an effective tax rate of approximately 24%.

A diluted share count of 11.8 million shares; depreciation of approximately \$3.5 million; amortization of approximately \$9.3 million; stock-based compensation of approximately \$11.9; and interest expense of approximately \$5.1 million.

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

Thomas Brisbin: Thanks, Stacy and good afternoon everyone. We delivered another strong quarter of revenue growth. We would have done better, but a few programs did not ramp until June, approximately five months later than we anticipated. We have experienced this before. Now that the program funding and scoping is finally renewed, we are back on track, not only for the remainder of this year, but the next few years.

Generally, we go two to three years of increase in organic revenue growth because of our major clients are not subject to transitions. These transitions have accounted for the minus 7% organic growth in the quarter. We expect low double-digit positive organic growth in the second half. I've said previously that our growth is like a step function and we are on the step right now and the stairs are going up.

As Stacy indicated, our overall outlook for the year remains very positive and guidance remains the same. We're pleased that our largest four clients as Stacy mentioned LADWP, Duke, Con and DASNY are running well and adding additional work. Unfortunately, for our people, we end up scrambling to deliver more in less time, although these are better problems.

Our people have been working diligently pursuing the California procurements. The new team members from acquisitions have been invaluable with their capabilities and experience. Willdan is a much stronger company today.

As we indicated on our last call, we had been shortlisted for all 11 of the programs that we initially submitted abstracts on. We're in the process of preparing full proposals that are due this summer, PG&E is due on August 2, that's tomorrow; San Diego Gas & Electric is due on August 23; Southern California Edison is due in October 23, and hopefully we will start to see awards by the end of this year.

In addition to those 11, we have also submitted an abstract for a new construction program being administered statewide by PG&E. Prior to our acquisition of the Weidt Group, we would not have been able to pursue this opportunity. But with the Weidt Group's expertise in new construction and Willdan's 50 year history and track record in California, we believe we have the qualifications to effectively compete for this substantial program.

California's a once in a generation type opportunity and we are highly focused on winning as much as possible. Our business development efforts related to the California procurement opportunities also led us to the recent acquisition of Onsite Energy.

As we have mentioned in the past, our preferred method for identifying acquisitions is through joint project work and bidding opportunities. We get to know each other and understand our capabilities and synergies. It is also very important that they review our culture, strategies and objectives and believe that they can grow not only themselves but Willdan overall.

We had partnered with Onsite Energy in submitting the abstract for an industrial program, and we both determine that their firm would be an excellent addition to Willdan. Onsite is an energy efficiency services and project implementation firm working at industrial facilities. This is part of the energy efficiency market that we didn't previously address.

The industrial energy efficiency market is larger than the commercial market. It can be less competitive than commercial. So from our perspective, it's a very attractive market. Onsite has built a strong track record in California, working with industry. For example, telecom, cement, aerospace, refrigeration, petrochemicals and data centers.

With our broad geographic presence, we will be able to take this expertise nationwide and substantially expand our addressable market. We're also seeing good momentum in the municipal utilities, which is adding to our pipeline of work.

We've been able to leverage the strong results generated from the LADWP program to win other municipal programs in California. These will start in Q4. We have other opportunities to expand our work with LADWP as Los Angeles continues to prioritize energy efficiency and close fossil fuel generation.

From a longer term perspective, we continue to build our track record in micro grid development. We're doing a great deal of work around the country from feasibility studies to conceptual development communities. Utilities are integrating micro grids as part of our efforts to enhance resiliency and deal with natural disasters such as fire, storms, earthquakes that impact the grid.

We're also finding new ways to apply our software and data analytics. We feel that our team has the capability to serve utilities, developers and cities in their quest to deploy assets for de-carbonization. Before I wrap up today, I want to say a few words about the progress we have made in positioning Willdan to be a leader in the next era of energy efficiency.

The industry has undergone enormous change in a very short period of time and we have made significant investments to ensure that we remain at the leading edge of innovation. The impact of the new technologies isn't fully understand within the industry, and that presents an enormous opportunity for Willdan. We have leading edge programs that will lead to more success for Willdan.

With that, I'd 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 opportunity to signal for questions. And we'll go first to Craig Irwin with ROTH Capital Partners.

Craig Irwin: Hi. Good evening and thanks for taking my questions. So, I wanted to ask about the five projects you mentioned that had delayed start-up in the quarter. Can you maybe give us a little bit more color on whether or not this was in a certain geography or if this was concentrated among certain of your largest customers or was this something that just happened in different areas of the country that you might be able to shed a little bit more color on for us?

Thomas Brisbin: I'm glad I write this down, Craig, because I said we have done better, but a few programs did not ramp up in June. And I restated that June, approximately five months later than we anticipated. So I said a few and a few were LADWP and Duke.

Craig Irwin: Okay, excellent. So LADWP and Duke really are number one and number two customers. You know, taking care of them and executing impeccably is always a focus. Can you maybe describe for us what's involved in the start-up of a program?

What sort of preparation goes in, whether or not you saw increased costs for this start-up of these programs and whether or not the timeline was what the customer had expected?

Thomas Brisbin: Mike, they're waiting for your question.

Mike Bieber: Sure. Well, Duke, we were added in three states. We were previously in North and South Carolina only and it was a lighting only program and now it involve HVAC and they have added the states of Ohio, Indiana and Kentucky. So we hired approximately 20 new people, new staff, to ramp up those new geographies and completely reconfigure the program for the new measures.

So now we've had a much better June, April and May were pretty weak in terms of sales. Sales has ramped up now and you typically have costs about 60 days prior to actually recognizing the revenue. You'll sell a program, you'll install the measure, and then you'll recognize the revenue about 60 days after you do the work.

So, if you look from a month by month standpoint, we really ramped up effort in April and May, and then started recognizing that higher level of revenue in June and that'll continue we think throughout the remainder of the year. And the same thing is going on in LADWP also.

We added the LAUSD, the school system. That is about in excess of $20 million in new work that they've added to the program and that is ramping up and will provide a big revenue boost in the back half of the year.

Craig Irwin: Excellent, thank you for that. Next thing I wanted to ask about was the cross-selling of Lime. So you obviously already have good traction in cross-selling with both Duke and LADWP, but there were a number of other geographies where you were optimistic that there might be an enhanced opportunity, New York, New Jersey, a couple international markets.

Can you maybe update us on the number of additional projects that you're seeing, the potential scope, the potential for this to be additive in 2020 as maybe some of these projects start to kick in?

Thomas Brisbin: I'll address New Jersey, we don't expect to see that adding into revenue until 2021. That's where that stands right now. As far as we've added a few municipal. Lime is one municipal utility churn in California, which is a big plus beyond LADWP. You mentioned international, we are looking at energy efficiency in some countries yet to be mentioned that we have started work on.

Mike, you got anything else on cross-selling?

Mike Bieber: I think the future opportunities for 2020 in Mid-Atlantic States are something that the procurements won't come out till about nine months from now, but we're doing the work, the upfront work right now.

Thomas Brisbin: Yes.

Craig Irwin: Excellent. Excellent. That's good to hear. And then, the investors I talk to, all of your investors, everybody is really thinking about the timeline for potential awards from California. We know there's a tremendous amount of activity and project development and effort put into the review cycle that's beginning to take shape right now.

Can you maybe give us some color on the timeline for us to see scope come out of the RFAs that you've responded to, and when can we start to get a clearer view on what your capture rate is of the enhanced California opportunity?

Thomas Brisbin: Schedule wise, which we didn't have last time we spoke last quarter is the RFAs, like I said, Robert have submitted. We submitted 11 or selected for a proposal phase for all. The proposals for PG&E are due tomorrow, and we think that's real progress. They're leading the pack right now of the California IOUs.

So, the next will be San Diego Gas and Electric proposals now, so that you can look at this as phase two. Phase 1 was the abstract, Phase 2 was the proposals. Then we don't know if they're going to have interviews, questions. We don't know what's going to happen next, and then there's going to be an award.

So we are in Phase 2, the proposal stage. San Diego Gas Electric is due August 23, which is 23 days from now and the SCE is due around October 23. And as I stated, hopefully, we'll see some type of award, I'd say. And it probably won't be public, because it'll be a long-term negotiation by the end of the year.

So by the time its public, first quarter next year and the beginning of the awards and if PG&Es continues to lead the way, we think we'll be there by the first quarter of next year.

Craig Irwin: Excellent. Excellent. And then, just another question along the same lines. So have you -- as you move from abstract to proposal, obviously the utilities have up selected certain contractors. Can you share with us, you know, approximately how much the field has narrowed?

And is it accurate that you've basically been up selected on essentially everything that you were looking to chase for the California opportunity?

Mike Bieber: That is accurate. We have been upscale, what do he say?

Thomas Brisbin: Up selected.

Stacy McLaughlin: Up selected.

Craig Irwin: Up selected.

Mike Bieber: Up-selected for … Okay, sorry, Craig. Up selected for all 11. How many have not been selected? You know, that'd be an estimate, because we don't know. But we do know of, let's say, how I say it, competitors that have not been up-selected. I don't have a percentage on that. And if I did, I probably couldn't say it. Your other question ...

Craig Irwin: And then once you move into the proposal stage, is it likely a winner takes all kind of scenario where if you were to win one certain proposal, you'd get all the business and someone else would get, you know, all the business of another proposal or is just something where they're likely be maybe a couple of contractors awarded scope of a proposal for a certain program?

Thomas Brisbin: Well, if I was talking to the utilities, if they were listening this call, I'd say, you should award it all to Willdan. But the reality is, I believe they'll be not, you know, we had 120 contractors three years ago. I think you're going to see that really, really go down to a few contractors.

And so I do not think there'll be a single award, I think there'll be multiple award, but we'll probably be in the area of one, two, three, may be four per segment, where there were 15 or 20 before. So, that's my best guess.

Craig Irwin: Excellent. And then last question if I may. Engineering and Consulting, I was pleasantly surprised by the growth there. Can you share anything that might help us understand the sort of short to intermediate term trajectory there, you know, that kind of suggests that the local municipal budgets are not quite as constrained as people were thinking. How should we be looking at this business?

Mike Bieber: So it was up 2% organically in the quarter. Good performance, we thought it might be down and it has been down in previous quarters. The leading indicator that business is the number of building permits that we're processing and we check each quarter about that and that has remained high and has not been reducing.

We're still cautious about that business. We think it will be flattish for the year, but they had a good quarter.

Craig Irwin: Great. Thanks for that. I'll hop back in the queue now.

Operator: Again, press star 1 to ask a question. And we'll go next to Moshe Katri with Wedbush Securities.

Moshe Katri: Hi, thanks for taking my question. So this is the second time this year that we've seen delays, and I guess, project start. Is there anything specific in terms of trend here? Is that the function of the fact that these are larger deals that are taking longer to structure or for the client to get comfortable with? Maybe you can give us some bit more color on that, just given the fact that it seems like a recurring kind of phenomena, at least this year. And then I have another follow-on. Thanks.

Thomas Brisbin: The first part of the question about the second time, it is not the second time. It's we're still operating on what happened in the end of last year actually. It continued until now. So the funding on LADWP has increased immensely.

And the deeper measures and more states on Duke, which Mike said, we're still dealing with the same two issues in this transition from the funding reauthorization on LADWP, and awarded more states and new measures for Duke. So, it's not a new delay. It's the same delay. We're just ...

(Crosstalk)

Thomas Brisbin: As I said, we …

Moshe Katri: Extended delay.

Thomas Brisbin: Yes, we thought we'd be out of it by now. And I said it went five months rather than a couple of months. And we've now seen progress in June, and so we believe we're out of it and we won't say it again.

Moshe Katri: Okay. And then, you know, you spoke about the fact that margins are going to be up nicely during the second half. Can you kind of quantify it for us in terms of levels? And I'm assuming a lot of this is a function of utilization rates, just people getting billable at this point.

Stacy McLaughlin: Yes, we would expect the adjusted EBITDA margin to be around mid-20s for the second half of the year. So for the entire year, we would be around the low 20%. As far as utilization, a lot of our programs are based on kilowatt savings. So it's not just a direct result of the utilization of our employees.

Moshe Katri: Okay. And then can we get some color on integral analytics? Where are we in terms of the sales cycle and the pipeline? Thanks a lot.

Thomas Brisbin: First, integral analytics is contributing nicely to all of our utility programs in energy efficiency. So we're integrating them well there. They had no major sales this past quarter, but they do have a robust pipeline of opportunities and some larger opportunities that we expect some will mature in the back half of this year.

Moshe Katri: Thanks.

Operator: And we'll go next to Andrew Gordon with EF Gordon Capital.

Andrew Gordon: Hi, good afternoon guys, and thanks for taking my questions. And the first one I have for you was, as you noted in your opening remarks, your net revenue margin is weaker over time which I believe is due to, I'm guessing, Lime's approach to using subcontractors.

And I wondered if this is something that you might get margin expansion from over the next, let's say, couple of years or so by possibly through your approach.

Mike Bieber: It is not a result of Lime's bigger use of subcontractors, because we report margin as a percent of net revenue which removes subcontractors. Our EBITDA margin was, I think, 16% this quarter.

(Crosstalk)

Andrew Gordon: No, no I'm sorry. I think maybe I wasn't clear. I meant, your net revenue margin, your margin versus your gross contract revenue. The portion that's been given to subcontractors.

Thomas Brisbin: Okay.

Mike Bieber: That increase. Pass through increase.

Thomas Brisbin: The pass through, you're right, did increase. It's up to, I think, pass through is 55% of our revenue now, up from about 45% last year and that is a result of the Lime acquisition. So you are correct. And so margin as opposed to gross revenue will come down, you're right, that's the result of the Lime acquisition due to the pass through and it's primarily equipment pass-through, we reported as subcontractors and equipment, but it's primarily equipment.

Moshe Katri: I see. My impression is that in the past in your core business you've been able to increase margin by a premier approach the use of subcontractors. I was wondering if that was a source of opportunity going forward. But my …

Thomas Brisbin: Yes, it's a potential source of opportunity. What's happening right off the bat though is that we're better absorbing our back office costs. Our corporate costs are not rising at the rate that revenue is rising. So, that will also contribute to margin.

Moshe Katri: Got you. My next question is just, it sounds like you have pretty high conviction in your net revenue guidance for the rest of the year based on working hand. And I'm just wondering whether you might comment on whether there are some moving parts as to how you might be better than that range depending on project still to be awarded or any other cross-selling opportunities?

Mike Bieber: We're only halfway through the year, and so let us get through Q3. It looks pretty good. We've got a lot of work in hand and our major customers, as Tom mentioned, have increased their budgets for us this fiscal year and going into 2020 as well.

So let's see how much work we can actually get in and completed this year. We'll update guidance next quarter.

Moshe Katri: Okay. Thank you so much.

Operator: And we'll go next to Tom Koch with Trancoso Partners.

Tom Koch: Yes. Hi, everyone. Can you hear me?

Thomas Brisbin: Yes, long time no hear.

Tom Koch: Long time no hear. Okay, question. Hey, Tom, can you just clarify one of previous questions? I thought when a utility grants a program to a contractor like yourself, be it, hospitality, hospitals, schools, that there is kind of one person like Willdan in one of those verticals for one of those utilities.

But I thought I just heard you say that there used to be like a whole bunch to now it's going down to four or five. Is it four or five, going to be four or five or just one person?

Thomas Brisbin: Oh, boy. So now you're getting into a competitive strategy. So I will try and answer it …

Tom Koch: No, not the strategy. I'm just trying to understand when PG&E grants a hospitality program award, and I'm using that as an example, I don't know if that's the case. When you go on the Web site, it says Willdan is the provider of that. Usually there's only one, there's not a whole bunch of people?

Thomas Brisbin: Right. So, they have a whole bunch of programs, hospitality, you know, hospitals, biotech, schools, they have, you know, 50 programs. And generally within that swim lane, they generally give it to one contractor. Now you can look bigger, Tom, you could break it into residential, commercial, industrial and public. And then under commercial, there's where what we're talking about, there is hospitality, hospitals, biotech, schools now, and on and on and on. So once you break it down to that level, yes, you're right. There's usually one award.

What they've asked for or what they have alluded to is the consolidation within a residential program like there might have been 10 programs within a residential. They'd like to see consolidation in that. They'd like to see consolidation possibly in commercial. So within that, as you go up into the categories, we believe there may be some consolidation. Does that answer your question, Tom?

Tom Koch: It does, it does, it does. Okay. And then second question I was going to ask, regarding Onsite. Did you guys provide information such as the acquisition price and the revenues and the EBITDA for that?

Mike Bieber: We said in the press release that it was about $20 million in revenue. The acquisition price was not disclosed in the press release and the effect of that that will be indicated in -- Stacy, our Q3 balance sheet. Is that correct?

Stacy McLaughlin: Correct.

Tom Koch: Okay. And is it profitable?

Mike Bieber: It is, yes.

Tom Koch: Okay. So when you are going through your guidance, I guess, that's not in the guidance yet because that deal hasn't closed yet. Is that correct?

Mike Bieber: That deal has closed. We elected not to update guidance for the effect of that until we get quarter on down the line. These acquisitions are only monitor -- moderately or only very slightly accretive in the first six months or so, but they are accretive in the first year.

So we didn't adjust guidance for that. We thought we would still perform within the range and we'll get to next quarter and reassess.

Tom Koch: Okay. So approximately $20 million divided by two, $10 million of revenues are in that guidance from Onsite.

Mike Bieber: Of gross revenue, yes. Net revenue is a much smaller number, about 1/3.

Tom Koch: Okay. Okay, perfect. So $20 million is gross revenues. Okay. All right. Thank you very much.

Thomas Brisbin: Thank you, Tom.

Operator: I show no further questions at this time, so I would like to hand the call back over to management for any closing remarks.

Thomas Brisbin: Okay. I'd like to thank all of you for participating on our call today and for your continued interest in Willdan and have a great day. Thank you.

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