Willdan Group
Third Quarter 2023 Financial Results Conference Call
November 3, 2023

Presenters
Al Kaschalk, Vice President of Investor Relations
Tom Brisbin, Chair and Chief Executive Officer
Kim Early, Chief Financial Officer
Mike Bieber, President

Q&A Participants
Craig Irwin - ROTH MKM
Richard Eisenberg - Private Investor

Operator
Good day, ladies and gentlemen, and welcome to the Willdan Group Third Quarter 2023 Financial Results Conference Call. Our host for today's call is Al Kaschalk, Vice President of Investor Relations.

At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session.

I would now like to turn the call over to your host. Mr. Kaschalk, the floor is yours.

Al Kaschalk, VP Investor Relations
Thank you, Martin. Good afternoon, everyone, and welcome to Willdan Group's Third Quarter 2023 Earnings Call. Joining our call today are Tom Brisbin, Chair 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 and the Willdan Investor Report that accompanies today's call in the Press Release and Stock Information section of our Investor Relations website. 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 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 30, 2022. 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 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 Chair and CEO.

Tom Brisbin, **Chair and CEO**
Thanks, Al, and good afternoon, everyone.

Willdan's strategy is to reduce the amount of electricity and natural gas that people use. In this clean energy transition to reduce carbon, we focus on how to make this affordable for people. We work for the largest, most stable customers--for example, governments, utilities and industry--who need to reduce their energy consumption for their customers.

The utilities and government are under extreme pressure to make this clean energy transition affordable. This is where Willdan is primarily focused. We are not in the generation of green energy or projects that require bank financing.

Very few of our projects require bank financing and are not impacted by interest rates. Our projects are generally incentivized and are affordable for people. Paybacks are generally less than two years and save people money. Willdan's strategy started with energy efficiency. Simply stated, use less electricity and save money. We have expanded greatly over the past 10 years.

To remind everyone, we are a professional service company, helping customers solve the problems with knowledge and software. We strive for affordable solutions. This word affordable cannot be stressed enough during this clean energy transition. People cannot afford significantly higher energy costs. Willdan projects help people save money.

For example, our new construction contracts for utility touched 10% of all new commercial building construction in the United States. All services and software are focused on saving energy--again, the word affordable.

Integral analytics software helps utilities modernize the grid at the least cost and highest benefit. We are agnostic to the generation source, whether it be solar, wind or battery, and we help integrate them into the logo grid at the least cost. For one of the largest health care groups in America, we are assessing 1,200 facilities in order to reach their decarbonization goals at an affordable pace.

For New York City, we completed the study for their 4,000 buildings. Using proprietary software, we prioritized what building and measures should be done first within their budget.

The common theme to our clean energy transition strategy has been an affordable reduction of carbon. Our strategy has always been to reduce the load on the grid and shift the demand. Our current electrification projects that increase the load are being coupled with demand response. This is where we can shift the load away from the time of day when electricity is expensive. Again, focused on affordable.

I want our investors, employees and customers to recognize what role we play in this decarbonization journey. Simply stated, affordable clean energy. It is a tough assignment. We have 1,600 really smart people for taking on this challenge.

Our business is growing again, post-COVID. Results of the last four quarters are evidence. Last quarter, we had a record trailing 12 months of EBITDA. Again, in this third quarter of 2023, we delivered another trailing 12-month record.

For the third quarter, we continued our solid performance. Our focused execution across the organization drove double-digit increases versus the prior year in nearly all of our key metrics. The team is converting this organic revenue growth, 11% for the quarter and 17% for nine months, through profit and cash flow.

Our strategy is working. I would like to share some of the many opportunities we are capturing, supporting our expanding backlog. We are sharing these new projects to give our investors confidence that our strategy has the momentum to continue our growth through 2024 and beyond. Despite the higher interest rates that are delaying and terminating large-scale projects, dependent on financing, our affordable solutions model is growing. Here are some examples.

Our Engineering segments are winning new projects and geography as well as integrating the energy transition that cities are embracing. Organic growth in this segment is 15% for the quarter and for nine months, it is also 15%.

Our Integral Analytics software group is having a great year, and their pipeline for '24 looks strong. We believe IA is getting better at selling the software and the demand is increasing.

Our Performance Engineering Group has won several new jobs that will be announced over the coming weeks. This service is being cross sold very effectively, throughout the organization. Our utility programs are going well. We have successfully restructured the California IOU programs. All recompetes this year were successfully won. We have also gained new utilities in the Midwest and Northeast.

Our engineering work in the Northeast, our New York City Housing Authority (NYCHA), the New York Power Authority (NYPA) and the Dormitory Authority of the State of New York are doing well and growing.

Summarizing our performance to date, the Willdan organization has recovered. It is functioning very well. We look to our E3 Group to continue leading us during this energy transition. We also anticipate looking to E3 to add capabilities in 2024.

In closing, demand for our services remains healthy, led by the energy transition and demand for municipalities. Given the strength in our end markets, our impressive year-to-date performance and our expectation for the momentum to continue, we are raising our 2023 guidance. Our strong financial position, further amplified by the successful refinancing of our credit facilities, puts us in a position to actively pursue strategic acquisitions that align with our business objectives.

I am confident that by executing our strategy, we are positioning the company to deliver strong long-term shareholder returns. I want to thank our employees, customers and stockholders for your support.

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

Kim Early, Chief Financial Officer
Thanks, Tom, and good afternoon, everyone.

Q3 reflects strong earnings performance and strengthening financial condition. For the nine months year-to-date, we generated $28.2 million in adjusted EBITDA and $24.1 million in cash flow from operations. The $28.2 million of adjusted EBITDA is a company record for the first nine months of the year, and the $40 million in trailing 12-month adjusted EBITDA is also a record.

Continued strong execution drove the improvement in operating results, providing the means to further delever the business and bring our leverage ratio to 2.2x adjusted EBITDA, as of the end of the quarter. This helped us complete the refinancing of our credit facilities during the quarter, thereby putting us in a position to continue the pursuit of strategic acquisition opportunities. We recently closed on a small addition to our Municipal Engineering segment that broadens our service offering, and we're currently seeking additional acquisition opportunities.

For Q3, gross revenue was up 9.3% over Q3 2022, to a record $132.7 million. Net revenue was up 10.8% to a record $65.3 million, fueled by our strong backlog and continuing demand across the broad range of our services.

We saw an 8% revenue growth in our Energy segment gross revenue, while the Engineering and Consulting segment grew revenues more than 10% over the prior year for the fifth consecutive quarter.

Q3 gross profit was 16% higher, year-over-year, as gross margin improved to 32.7% in Q3 2023, versus 30.9% a year ago, reflecting the restructured California IOU contracts and improved productivity throughout the business.

Despite the strong growth in revenues, Q3 G&A expenses were up only 3.4% versus the same period a year ago with lower stock compensation, depreciation and interest accretion on earn-out liabilities, partially offsetting higher employee compensation.

Interest expense, on the other hand, increased 70% to $2.4 million in 2023 from $1.4 million a year ago, due to the higher interest rates.

Our income tax rate was 31% in the third quarter, compared to a tax benefit of 105% for the third quarter of 2022.

So for the third quarter, net income was $1.6 million, or $0.11 per diluted share versus net income of $76,000, or $0.01 per diluted share a year ago. Adjusted EBITDA in Q3 of this year was $10.1 million, up 27% over the $8.0 million in Q3 of 2022. Adjusted earnings per share in Q3 of this year was $0.37 versus $0.42 in Q3 a year ago, mainly reflecting the difference in tax rates.

In terms of the nine months ended September 2023 versus the nine months of September 2022…

Gross revenue was up 12.2% to $354.4 million, and net revenue was up 16.6% to $188.9 million, with solid growth across all our service lines and increasing momentum supported by a strong backlog.

Gross profit increased 25% as gross margin improved to 35.4% in 2023, compared to 31.8% a year ago, driven by higher software licensing and improved performance on our restructured utility contracts.

We realized significant operating leverage in the period as G&A expenses increased only 2.6% versus the same period a year ago, while the net revenues had grown 16.6%.

Higher employee incentive compensation, consistent with the improvement in income from operations, was partially offset by lower stock-based compensation and lower interest accretion on earn-out liabilities, which have now all been satisfied.

Interest expense increased by $3.9 million to $7.1 million for the nine months ended September 2023, compared to $3.2 million in the same period a year ago, due to the higher interest rates.

Year-to-date income tax expense was $1.7 million, or an effective rate of 37% compared to an income tax benefit of $5.6 million on the loss in 2022. The relatively high effective tax rate reflects the impact of certain reduced deductions in prior year returns resulting from the lower stock price on the stock compensation, which vested in the first quarter of this year. For all of 2023, we now expect an effective tax rate of approximately 29%.

Thus, year-to-date net income was $2.9 million, or $0.21 per diluted share, compared to a loss of $8.0 million, or $0.62 per share in 2022. Improved results throughout the company enabled a significant turnaround.

Our balance sheet also reflects the benefits of our improved earnings and the higher cash flows. At the end of September 2023, our leverage ratio improved significantly to 2.2x trailing 12-month adjusted EBITDA, and net debt was $86.5 million. During the quarter, we paid off the $5 million outstanding under our line of credit, while maintaining a healthy $12.9 million cash balance at the end of the quarter.

On September 29, we completed the refinancing of our bank credit facilities and entered into a new 3-year credit agreement with a syndicate of five banks, jointly led by BMO and JPMorgan. We used the proceeds from the credit agreement's term loan to repay and terminate the prior credit agreement, which was scheduled to mature on June 26, 2024, as well as to fund the fees and expenses associated with the refinancing. The new credit facilities will provide working capital, finance capital expenditures and acquisitions and serve other general corporate purposes to continue to grow the company. As of the end of September and currently, there were no outstanding borrowings under our $50 million revolving credit facility.

With the performance delivered year-to-date and our expectations for a strong fourth quarter, we're raising our 2023 financial guidance.

For all of 2023, we now expect net revenue growth of 10% to 12%, implying net revenue in the range of $250 million to $255 million. Adjusted EBITDA is now expected to be in the range of $40 million to $42 million, implying a fourth quarter EBITDA of $12 million to $14 million. Adjusted diluted earnings per share in the range of $1.33 to $1.38. We're raising our estimated full year tax rate to 29% and assuming a diluted share count of 13.7 million. Our capital expenditures are expected to be in the range of $10 million to $12 million.

Operator, we're now prepared to answer questions.

Operator
At this time, we will conduct the question-and-answer session. If you would like to ask a question, please press "*", then the number "1" on your telephone keypad, now, and you will be placed in the queue in the order received. Once again, to ask a question, please press "*", then the number "1" on your telephone keypad, now.

Your first question comes from Craig Irwin with ROTH MKM. Your line is open.

Craig Irwin, ROTH MKM
Congratulations on another really strong quarter here.

Tom Brisbin, **Chair and CEO**
Craig, this is the crew You're breaking up a little bit. Could you get a bit closer and start over?

Craig Irwin, ROTH MKM
Hey, I wanted to say congratulations on another really strong quarter here to start. Is that clear?

Tom Brisbin, **Chair and CEO**
You came through loud and clear. You can say it again, if you want.

Craig Irwin, ROTH MKM
It's a great job. How's that?

Tom Brisbin, **Chair and CEO**
All right.

Craig Irwin, ROTH MKM
Yeah, so Tom, I really appreciate that you hit the interest rate question head on, right, in your prepared remarks. There's a lot of chatter out there with investors. People are looking at the solar industry and the wind industry and knowing that there's a lot of projects that are kind of being pulled off the table because interest rates have gone too high for those to be profitable to finance.

But you're beating numbers, raising guidance. Obviously, your customer base out there is still doing quite a lot of consulting activity looking at renewables and other projects that they want to develop.

Can you maybe talk a little bit more about the character of these projects? Are they likely to just maybe take one or two scoops less of a different flavor of ice cream than solar or something? Are we looking at maybe slightly smaller projects? And how do you see this interest rate environment impacting the broader opportunity set that Willdan's supporting its customers and addressing?

Tom Brisbin, **Chair and CEO**
Craig, that's three questions in there. Mike's going to take a couple. I just want to start off with we would like to differentiate ourselves from the solar industry that is so tied to interest rates. Do you think we've done that in what we've said?

Craig Irwin, ROTH MKM
I think it's very clear, yes.

Tom Brisbin, **Chair and CEO**
It's very clear. So your next question was what solar projects are we doing, I think was your next question.

Craig Irwin, ROTH MKM
You can address that much. That'll address it in one way. Yes

Tom Brisbin, **Chair and CEO**
All right. Well, we do very few. If it's a customer like a hospital or something that wants solar, but we will do it. Solar is not what we're doing. We're helping them decide what they should do, but we're not in that business. Mike, do you want--a few products where we are doing solar or battery, it's so small.

Mike Bieber, President
They're additions to bigger projects that focus on decarbonization or energy efficiency channel.

Tom Brisbin, **Chair and CEO**
Yeah. And I don't know what you're looking for with that question, Craig. But I want to make sure we really make it clear that we're consulting, helping people decide what they should do. And when--and that big hospital chain I talked to, they don't want to do a project unless their IRR is 11%.

So we are scraping through their 1,200 facilities trying to show them what they can do with incentives and other things to meet their internal rate of returns. And that's the type of work we do.

We also do with the utilities, all these commercial buildings and commercial customers, small businesses, they're all getting incentives that are part of the special purpose tax, where the money is already there. In California, it's $1 billion; New Jersey, it's $1 billion; New York, it's almost $1 billion. And so, we're working off some money that's already there. It doesn't require bank financing or susceptible to interest rates.

And the third part of your question, Craig, was?

Craig Irwin, ROTH MKM
Well, how do you see this impacting the project sizes and project velocity that Willdan is addressing? Obviously, it doesn't change the count of the number of total hospitals out there; 1,200 for one is pretty good. But do you imagine this--shrinking the number of hospitals that would be considering a proper analysis that Willdan would do to review their options as far as energy efficiency and renewables?

I can't imagine that scenario, but maybe you can talk us through whether or not interest rates address--whether or not they impact the total opportunity consulting for hospitals across the country?

Tom Brisbin, **Chair and CEO**
I can't see it because they're highly driven by 2030 and 2050 decarbonization goals. They're actually looking for more help, in my opinion, to try to figure out how to get there with their financial crunch. So, we are not seeing any decline in their interest; we're just seeing more motivation on how they get there.

And that requires actually like our E3 Group, a lot smarter people because they know what's coming in the future, they help these companies see it, and then they dig through all the possibilities, whether it be the IRA money, incentive money in the utilities. So, I don't see it shrinking that problem because we all have goals to meet. Mike, do you have anything to add to that?

Mike Bieber, President
No. And it partially explains why our results are getting stronger and stronger, as interest rates have gone up 5%. There's no correlation. The projects are dropping off or getting more difficult, we're actually accelerating right now.

Craig Irwin, ROTH MKM
Excellent. That actually--that answers what I was going to put up as my next question a little bit, but maybe I'll ask in a slightly different way. So typically, during periods of economic weakness, you mentioned the financial crunch, Tom. The CFOs of different institutions take a look and say, where can I save money? Now Willdan's energy efficiency business exists because it delivers verifiable savings to the customers.

So can you maybe talk about the tempo of activity away even from some of these IRA or renewables-related projects? Are you seeing sort of the countercyclical impact of sort of economic weakness, interest rate--higher interest rates and these other factors in the environment driving an elevated tempo of activity across your customer base?

Tom Brisbin, **Chair and CEO**

Well, we've said before, we're doing zero to very few IRA-type projects; that might pick up in the future. How that flows down, we don't know. We see money coming through the green banks for financing. I think this whole strategy that we've talked about here was preparing for this day, given our 2007, '08 experience, most of every part of what we do in Willdan now.

We went right through the recession '07, and '08 and '09, without a hit. And we haven't seen one yet. We have a little bit of the canary in the coal mine here with the Engineering business. As I told you, they're up 11%, 12%, 13%.

There's a couple of explanations that we have hypothesized what's going on in this economy. One, it's harder to get people. So, these municipalities versus '07-'08 are using our people outsourcing it. We always talked about the day that we figure out outsourcing is cheaper than hiring. And maybe with the way the retirement structures are in municipalities, they finally figured out they can't afford to pay for one physician, two or three people, their retirement.

So we see--we're not seeing what we thought we would see in municipalities. It's actually increasing when we think it should be decreasing. So I think we're blocking the trend the right way. As Mike said, the numbers show we are. And I don't know if I completely got this question, Mike. Have you got anything to add to that?

Mike Bieber, President
We don't know whether higher interest rates are accelerating our business or not yet. I don't think we have enough data. That was exactly what your question was, I think, Craig, but we are accelerating and there are higher interest rates. How about that?

Tom Brisbin, **Chair and CEO**
When can higher interest rates ever help anyone.

Mike Bieber, President
Yeah, a hypothesis. Say it again, Chief.

Tom Brisbin, **Chair and CEO**
Yeah. Saving energy would be it, yeah. But I know interest rates are never any good for anyone.

Craig Irwin, ROTH MKM
Understood. Understood. No, you guys are definitely showing momentum. So then last question, if I may. Can you give us a quick update on Integral Analytics? This is obviously a real gem at Willdan and can be lumpy from time to time.

Is there anything in front of commissions right now that you think is notable that we should get an update on? Or is there anything--given this elevated level of activity for planning for renewables, are we likely to see some of these contracts be awarded before the end of the year?

Mike Bieber, President
We have a great pipeline right now, and it's going to carry over into 2024. I'm not going to get into specifics because we're in the middle of specifics on a few of these. And it is possible some would be executed and announced before the end of '24--or '23 rather. We're also carrying a great pipeline into 2024.

These states are in places where distributed energy is a bigger proportion of generation pressuring the utilities to modernize and adopt tools like IA software. So there's strong demand that is increasing in new states that we have not worked before.

Craig Irwin, ROTH MKM
Excellent. Well, thank you. Congratulations on a strong quarter. I'll go ahead and hop back in the queue.

Operator
Once again, to ask a question at this time, please press "*", then the number "1" on your telephone keypad. Your next question comes from Richard Eisenberg (ph), a private investor. Your line is open.

Richard Eisenberg, Private Investor
Good afternoon. Should we expect any sizable acquisitions in the fourth quarter or in the first quarter of next year? Thank you.

Tom Brisbin, Chair and CEO
Well, Richard, I don't know if we know you, met you on the road. Who are you with if you can say or you just like the answer to question.

Richard Eisenberg, Private Investor
I'm a private investor.

Tom Brisbin, Chair and CEO
Okay. Go ahead, Mike.

Mike Bieber, President
We don't forecast acquisitions and none is in guidance or in the raise, I want to point that out. We announced and when we closed them. Having said that, we just got our credit facility renegotiated.

We're just starting to reinitiate our acquisition process. It's possible we could have acquisitions soon, but we're just starting the reinitiation process, and it's more likely that it will be later in 2024, but not out of the question that it's earlier.

Richard Eisenberg, Private Investor
Okay, thank you very much. Congratulations on a good quarter.

Tom Brisbin, Chair and CEO
Thank you for being an investor.

Operator
At this time, it appears there are no further questions. I would now like to turn the call back over to management for any closing remarks.

Tom Brisbin, Chair and CEO
Well, thank you, all, who are on the phone, employees, shareholders, possibly customers. It's great working with all of you. It's been a great year, and things are improving here in Willdan, and we hope to keep you going. So thank you very much.

Operator
This concludes today's Willdan Group Third Quarter 2023 Financial Results Conference Call. Thank you for attending, and have a wonderful rest of your day.