WILLDAN GROUP, INC.
Q4:2020 and FY2020 Earnings Conference Call
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CALL PARTICIPANTS

EXECUTIVES – WILLDAN GROUP

Al Kaschalk – VP Investor Relations
Tom Brisbin – CEO & Chairman
Stacy McLaughlin - CFO
Mike Bieber - President

ANALYSTS / INVESTORS

Moshi Katri – Wedbush Securities
Craig Irwin – Roth Capital
Marc Riddick – Sidoti & Company

PRESENTATION

Operator
Please standby everyone, we're about to begin. Good day, everyone, and welcome to the Willdan Group Fourth Quarter and Fiscal Year 2020 Conference Call. Today's conference is being recorded. And at this time, I'd like to turn the conference over to Al Kaschalk, Vice President, Investor Relations. Please go ahead, sir.

Al Kaschalk, VP Investor Relations
Thank you, Telari. Good afternoon, everyone, and welcome to Willdan Group's Fourth Quarter and Fiscal Year 2020 Earnings Call. Joining our call today are Tom Brisbin, Chairman of the Board and Chief Executive Officer; and Stacy McLaughlin, Chief Financial Officer; and Mike Bieber, President of the Willdan Group.

The call today builds on our earnings release we issued after market close today. You may find the earnings release and the Willdan investor report that accompanies today's call in the Investors section of our willdan.com 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'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 annual report on Form 10-K filed for the year ended December 27, 2019, and subsequent quarter reports on Form 10-Q, including quarterly report on Form 10-Q filed for the quarter ended April 3, 2020. The company cautions investors not to place undue reliance on the forward-looking statements made during the course of this conference call.

Willdan disclaims any obligation and does not undertake to update or revise any forward-looking statements made today. In addition to GAAP results, Willdan also provides non-GAAP financial measures that we believe enhance investors' ability to analyze the business trends and performance. Our non-GAAP measures include net revenue, adjusted EBITDA and adjusted EPS. We believe that net revenue defined as 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 EPS and adjusted EBITDA are supplemental measures of operating performance, which removes the impact of certain expenses – 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. We expect to file our Form 10-K next week.

Stacy will provide a financial discussion and will be followed by Tom. After management's prepared remarks, we will take your questions. Stacy, over to you.

Stacy B. McLaughlin, Chief Financial Officer

Thanks, Al. I'll start with a brief recap of our business and provide financial details on the fourth quarter and fiscal year 2020, including our income statement, and then discuss our balance sheet.

Since our last earnings call, the overall business environment did not materially change during the fourth quarter. The small business program for the Los Angeles Department of Water and Power, LADWP, remains suspended. Despite traditionally being seasonally weaker quarters in the third quarter, fourth quarter consolidated net revenue decreased only 0.5% sequentially from the third quarter. For the fourth quarter, overall, our revenue was on plan, and our profit was slightly ahead of plan.

Total contract revenue for the fourth quarter of 2020 decreased 25.1% to $96.9 million from $129.4 million for the fourth quarter of 2019. The decrease is primarily due to the COVID-related suspension of the LADWP small business program within the Energy segment. Net revenue was $50.8 million, a 16.8% decline from $61 million in the year ago quarter. While net revenue in our Engineering and Consulting segment decreased 2.5%. Net revenue in our Energy segment decreased 21%.

Direct costs of contract revenue were $62.4 million in the fourth quarter of 2020, a decrease of 27.6% from $86.2 million in the same period last year. The decrease was primarily as a result of decreased contract revenue from our COVID-related suspension of our LADWP program, partially offset by additional direct costs of contract revenue related to our acquisition of E3.

Total general and administrative expenses for the fourth quarter were $40.2 million compared to $37.7 million for the prior year period. The net increase in general and administrative expenses were primarily due to an increase in contingent consideration for Integral Analytics.

We recorded a tax benefit of $1.9 million for the fourth quarter compared to a tax expense of $1.2 million during the same period a year ago. The increase in the tax benefit is primarily attributable to our loss before income tax.

We had net loss in the fourth quarter of 2020 of $4 million or $0.33 per diluted share compared with net income of $3.2 million or $0.27 per diluted share in the same period last year.

Fourth quarter fiscal year 2020 adjusted diluted earnings per share was $0.46, a decrease of 52.6%. The most significant adjustments from our GAAP net income were interest accretion related to increase in contingent consideration, stock-based compensation and intangible amortization, which are all noncash items. Adjusted EBITDA was $8.6 million for the fourth quarter of 2020 or 16.9% as a percentage of net revenue.

I will now provide a recap of fiscal year 2020 financial results versus fiscal year 2019.

For fiscal year 2020, consolidated contract revenue was $391 million, a decrease of 11.8% over the prior year. Revenue in our Energy segment declined 12.6% due to COVID-related suspensions of our direct install program, which was offset by $31.2 million of incremental contract revenue generated from state and local government projects and $22 million of incremental revenue from the acquisitions of Energy and Environmental Economics, also known as E3, and Onsite Energy Corporation, also known as Onsite. Contract revenue in our Engineering and Consulting segment decreased 7.7%, primarily due to decreased subcontractor revenue, combined with a reduction in scope of work related to one of our customers. Net revenue was $194.5 million, a decrease of 2.5% in fiscal year 2020 compared to 2019. Net revenue for our direct install program for small businesses in our Energy segment decreased 3.9% as a result of business suspensions resulting from COVID-19 pandemic and efforts, while net revenue in our Engineering and Consulting segment increased 1.1%.

Direct costs of contract revenue decreased $46.5 million or 15% in fiscal year 2020 compared to fiscal year 2019. Direct costs of contract revenue decreased as a result of decreased contract revenue from our direct install programs in our Energy segment, partially offset by an increase in direct costs related to increases in contract revenue generated from state and local governments. In addition, there were $7.9 million of incremental direct costs of contract revenue related to our acquisition of E3 and Onsite.

Total general and administrative expenses for fiscal year 2020 was $145.6 million, an increase of $20 million or 15.9% compared to fiscal year 2019. The net increase in general and administrative expenses was primarily attributed to the addition of prior acquisitions, combined with increases in stock-based compensation, intangible asset amortization and other corporate general and administrative expenses, partially offset by our cost-saving measures instituted in response to COVID-19.

We reported a tax benefit of $5.2 million for fiscal year 2020 compared to a tax benefit of $0.2 million for fiscal year 2019. The increase in the tax benefit is primarily attributable to our loss before income tax and reduced energy-efficient commercial building deductions, otherwise known as 179D. In December of 2020, 179D was passed permanently, which will improve the company's cash flow on a go-forward basis.

We had a net loss of $14.5 million or $1.23 per diluted share in fiscal year 2020 compared with net income of $4.8 million or $0.41 per diluted share for fiscal year 2019. Fiscal year 2020 adjusted diluted earnings per share was $1.30 and was above Wall Street's consensus estimate. Adjusted EBITDA was $28.1 million.

Turning to the balance sheet and cash flow from operations. We entered 2020 focused on improving our cash flow with an emphasis on cash collection, particularly from some of our large utility customers. At the end of fiscal year 2020, we had $28.4 million of cash and cash equivalents. Our cash increased by $22.9 million since the end of fiscal year 2019. For fiscal year 2020, we generated a record level of $47 million in cash flow from operations. By comparison, in fiscal year 2019, we generated $11.6 million in cash flow from operations. I would like to thank the efforts of the accounting and operations team in diligently working hard to manage cash flow throughout the year. This was an outstanding result.

At January 1, 2021, total debt was $114 million, including $113 million outstanding on our credit facility. We have no borrowings under our revolving credit line, with $50 million available. Net debt, defined as debt less cash, dropped $28.4 million during the year from $104.4 million, down to $75.6 million at the end of Q4.

We anticipate redoing formal yearly guidance for the company's largest program resumed full activity, this being the LADWP direct install program. This contract is funded at $66 million per year, and in our internal plan, we are presuming that this program resumes in early summer. Secondly, we are expecting approximately $40 million of revenue to come from our new California IOU program in 2021, and most of this revenue is expected to be recognized in the fourth quarter. The California IOU programs are expected to contribute up to $150 million of revenue in 2022 and continue to grow into 2023. Most of the remaining work in our plans have already been secured for 2021, and COVID restrictions are already beginning to lift in California, providing us increasing confidence this year. I'd now like to turn the call over to Tom.

Tom Brisbin, Chief Executive Officer

Thanks, Stacy, and good afternoon, everyone. During our call this afternoon, we will highlight our fiscal year 2020 activities, provide an update on business development and some thoughts on the year ahead.

Before we begin, it would be fair to say that Willdan is in the right space at the right time. That space is sustainability. We believe the market is just beginning and will continue to grow. We help our customers save electron, water and natural gas, all required to be more sustainable.

Now let's look at 2020. First, I would like to thank all our employees. 2020 was an extraordinary year due to the COVID-19 pandemic. We had to change how we do business and our financial sacrifice for all. Our employees' resiliency and dedication have been greatly appreciated. When COVID struck in early March, we were tracking to a record quarter and year. Then with COVID, about 40% of our business slowly came to a halt. This 40% was primarily our utility direct consultant business, where we assist utilities customers across the nation with energy efficiency. We interface daily with commercial, industrial, multifamily and public sector customers. We actively conduct sale, energy audit, installations and construction inspections at our customers' locations. This customer interface came to a rapid halt as utilities, cities and states locked down to prevent the spread of COVID-19. Fortunately, 60% of our work was not affected by the lockdown, and our employees were able to work from home. It should also be noted that most of our state and local work was identified as essential. We took immediate action to limit the effects of the COVID financial impact. As a company, we matched our costs with declining revenues. To reduce costs, we had furloughs, layoffs, salary reduction, board fee suspension, suspension of 401(k) match funds and stopping all discretionary spending. We also took measures to ensure the health and safety of our employees. We kept the health benefits in place for all, except layoffs.

On May 6, we amended our credit agreement that provided increased flexibility under our debt covenants through the second quarter of 2021. Starting in the second quarter and continuing through the end of 2020, we saw many products resume as shelter-in-place, total lockdown orders and business limitations were lifted and scaled back. Thus, by the end of the year, we were down 3% on net revenue from 2019 and only 12% down from our budget. I would like to point out that no contracts have been canceled and no budgets reduced. In all cases, the work was only delayed.

Despite the impact of COVID-19, customers actively conducted procurements. In 2020, we won a record amount of new work. The synergy of our acquisitions was the key factor along with past performance. After two years of negotiation, the California IOUs awarded Willdan six California energy efficiency contracts totaling $781 million or approximately 88% of what we bid on. The California IOU contracts are expected to have an average duration of four to five years.

The programs are expected to ramp in the second half of 2021, with peak ramp expected to occur in years three and four. Additional budget is likely to go into programs that can ramp, execute project milestones and deliver required savings. To date, this only represents 25% of the outsourcing that the California IOUs have done. They must outsource 100% of their energy efficiency services by 2025 as mandated by the California Public Utilities Commission.

In 2020, we took a major step in combining capabilities as an organization, and we were successful. For example, in New York City, we leveraged our utility and government policy relationships to win a competitive contract, develop an action plan for the city of New York, government operations. The contract was in response to the most ambitious local climate laws in the United States and leverages our ability to develop policy models and pathways for decarbonization. Our success on the new construction program for all California highway use leverage Willdan's collective capabilities, including the 2019 acquisition of The Weidt Group. Prior to our acquisition, The Weidt Group performed approximately 10% of all new construction work in the United States. In 2021, Willdan will be involved in 100% of the new construction, excluding residential in California due to the new utility contracts. California will lead the way on new construction in order to meet their aggressive climate goals. On the municipal front, Pueblo County School District 70 selected Willdan as the design build contractor for facility improvements. Willdan will provide engineering and construction management to update 19 schools and 4 district buildings. Contract value is $76 million over two years. Lastly, Integral Analytics has a robust pipeline of software opportunities this year.

Amidst the pandemic, racial and justice came to the forefront, triggered by the death of George Floyd. In the summer of 2020, our employees established Willdan Diversity, Equity, and Inclusion Working Group, called the DEI Working Group. So this group is focused on recruitment, inclusive culture, business partnerships and community engagement with employees, suppliers and subcontractors, reflecting the communities where we live and work. We believe we will better serve all communities. We issued our Inaugural Sustainability Report in January 2021. At Willdan, sustainability is our business. Our climate mitigation efforts are increasingly important to our customers and other key stakeholders. Our goal is to facilitate a more efficient and rapid transition to a clean energy economy by mitigating carbon emissions in buildings, transportation and power production.

Our experience of providing climate, mitigating road maps with progressive states such as California, New York and Hawaii, help us build a diverse and highly synergistic set of capabilities. We believe we are aligned with the country's transition to a net zero economy, one that emits no more carbon dioxide than have removed from the atmosphere by 2050.

We expect continued impact in the first half of 2021 as the Los Angeles Department of Water and Power remains delayed. The small business program in Los Angeles County continues with closure restrictions put in place since late March 2020. We now expect this program to resume by July 1, 2021. The Los Angeles Unified School District program will resume earlier than July 1, helping to ease the burden of the LADWP restrictions. In terms of the IOUs, we expect the CP usage to provide the ruling on the four remaining contracts announced by the California IOUs over the next 90 days.

On behalf of our Board of Directors, management and shareholders, we would like to thank our employees and customers for their dedication and hard work during this pandemic. I also want to thank our teams for their commitment to developing and implementing effective protocols to keep our employees safe and projects running. The health and safety of our employees is our first priority, and we are proud of our accomplishments during an extraordinary year. The trend for reducing carbon emissions continues. And once the economy opens up again, we believe that there will be even more demand for our services. We are positioned to produce double-digit organic growth for the next couple of years. Operator, we are ready to begin the question-and-answer session.

QUESTION AND ANSWER

Operator

Thank you. If you'd like to ask a question at this time, you may signal us by pressing star one your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach us. Once again, that's star one to ask a question. We'll pause for just a brief moment. We'll take our first question from Moshe Katri with Wedbush Securities.

Moshe Katri, Wedbush Securities

Congrats on the very strong bookings through last year. So we were waiting for the bookings to come through, and it seems like you're able to do really well in terms of some of those competitive wins. The big question now is, how does it translate into the financials for the second half? I appreciate the color about double-digit growth during the next few years, but can we get some more clarity on how Q3 and Q4 could look like, especially given the fact that visibility looks better for Willdan as a whole?

Mike Bieber, Willdan

Sure, Moshe. This is Mike. We said that we expected around $40 million of revenue in the back half of the year and that most would be in the fourth quarter. The way we'll book revenue on these contracts is that we won't actually record revenue until about 75 to 90 days after we do the work. So that's the reason we're ramping up the contracts right now. And the ramp-up will occur in Q2, but we'll recognize the revenue for that ramp-up in Q3. And then as we continue to ramp up, one of the contracts, for instance, starts at the beginning – or the end of Q3, we won't be recording revenue bid until Q4. So if I had to split the $40 million, this is just a guess, maybe $12 million or so in Q3 and the balance in Q4, something like that.

Operator

And we'll move and take our next question from Craig Irwin with ROTH Capital Partners.

Craig Irwin, ROTH Capital Partners

Can you maybe start with a discussion of the stimulus that's proposed? There's a lot of sort of back room conversations going on right now. A lot of people in D.C. are talking quietly to their contacts across the country, saying that almost anything we ask for, we get. What do you think the probability is that we'll see fairly heavy spending in energy efficiency, utility services, carbon abatement, really, which is – the areas that you're focused on, it sounds like there's a tremendous amount of activity coming.

Tom Brisbin, Willdan Group

That is true. There's a lot of talk. We are – we have one of our Executive Vice presidents fully committed to working with lobbyists in Washington on that to ensure legislation gets, how do I say it, climate change at the forefront, energy efficiency at the forefront. So we are actively engaged in that type of activity. Craig, how much gets here and when? I don't know, but it's a hot topic. That's all I can really say.

Craig Irwin, ROTH Capital Partners
Understood. Understood. The other thing, I was kind of hoping for an update on Integral Analytics, right? This is a business where when it's coming along, when it's producing for you, (is it really this) contributor to the profitability of Willdan. Can you update us on any changes in the pipeline for Integral Analytics? Are you seeing some of these contracts that have been out there now, I guess, for more than two years continuing to inch forward? Are you seeing customers coming in for integration revenue that would point to probable future license agreements, license signatures, whatever you want to call them, that would really give us visibility on some of this chunky high profit revenue materializing?

Mike Bieber, Willdan
Sure, Craig. This is Mike. We said that we've got a robust pipeline, and we see coming into 2021. It – there's a lot of large clients that we've been talking with for a number of years that seem much more interested and ready to sign this year for whatever reason. There's a lot more activity than there was last year. Now the conversations have actually gone within the group. How do we get all this work done if everything gets in 2021 that's now in our pipeline? So it looks really good. I won't say anything more than that until press releases come out. And so we're in a good spot right now for 2021.

Craig Irwin, ROTH Capital Partners
Understood. Understood. And then just looking at the P&L for the quarter. In your general and administrative expenses, you break out several line items. And one of it is labeled other. That was up materially, was up $4.7 million year-over-year to $12.051 million. Can you maybe help us understand what's in that line item and why we saw such significant growth there while the revenue growth has been tepid given the COVID headwinds?

Stacy McLaughlin, Willdan
Craig, it's Stacy. The increase there is related to an increase in the earn-out or contingent consideration for Integral Analytics and the California IOU wins. That's why there's a big jump from Q4 2019 to Q4 2020.

Craig Irwin, ROTH Capital Partners
So if we were going to take an earn-out out of earnings to get to an adjusted number, which a lot of analysts do think is the right way to do things, what is the approximate size of the earn-out contribution in there? Is this really something like $4.7 million? That would mean, on an operating basis, you had an absolutely fantastic quarter.

Stacy McLaughlin, Willdan:
Yes, it's actually the earn-out was an increase in expense in that other row of about $6 million, which is then offset by some other smaller items within. If we had not booked that increase in earn-out in Q4, we would have also had positive GAAP earnings.

Craig Irwin, ROTH Capital Partners
Wow. Okay. That's a good deal. Now, I guess, the quarter looks really different for those of us paying attention.

Operator
Once again everyone, star one if you have a question or comment. We'll move next to Marc Riddick with Sidoti.

Marc Riddick, Sidoti
I was wondering if you could talk a little bit about it. I appreciate all the detail that you've given on the – on multiple fronts, but particularly some of the work that you're going to be doing in the

timing that you see coming for a lot of things that have been delayed as well as California. I wanted to talk a little bit about how that may play as to visibility of labor needs and how we should think about maybe that mix of what we should expect to see first half versus second half as far as subcontractor work and the like.

Mike Bieber, Willdan
With respect to labor, we are hiring, and we looked at more than 50 people right now. We've been adding several per week over the last few weeks. So look for those metrics to go up. Labor availability has not been a major issue for us. We have been able to effectively recruit and hire. So that's been good for us. Did you have anything else? Because we couldn't understand. You were breaking up a little bit on the latter part of your questions, Marc.

Marc Riddick, Sidoti
What the mix of that labor might look like, I guess, for the first half, since you're going to be ramping up for the work that you're going to be doing back half and beyond. So I'm sort of thinking about, are we – is it reasonable to expect that increase in mix of subcontractor needs? Or do you think you're going to be hiring and that's – some of that to be – more of that to be internal?

Tom Brisbin, Willdan
We do have a lot of commitments to subcontractors that were incumbents, that all joined our team. And it's a big plus because they can hit the ground running to deliver these savings goals. So I imagine the subcontracting during the start-up phase would be higher than when we level off, I can say, 60%, maybe 70%. They're on the ground waiting to start, and that takes away – that helps us a lot because we don't have to carry those costs of start-up. And then we can hire people over the next three to six months to fill in and bring it down to about a 50% subcontract level. And within that subcontractor level, we also have ((inaudible)), and we're fortunate to have minority business enterprises already on the team. So we're not expecting a very difficult start-up.

Mike Bieber, Willdan
And Marc, those percentages Tom just gave were just a result of the incremental California work, not the portfolio overall.

Marc Riddick, Sidoti
Okay. That's very helpful. And then it was nice to see, in addition to the earnings release note of – the note of another new business win. I was wondering if you could talk a little bit about it, and this might be a bit fishy, but I was wondering if you could talk about the – whether it's inbound or how we should think about increased interest from your customer groups over the last few weeks while taking into consideration the funding environment, which has certainly changed since the beginning of the year from – as far as government funding availability, and now, of course, with the passing of the stimulus.

Tom Brisbin, Willdan
I think if you mix COVID with the excitement of increased funding, you come out about neutral. That's where we are. So we could get excited about funding. The customers know it's coming, the cities, the states. But you also have the unknowns of COVID. So I'll ask a consensus of Mike and Stacy. Are we at about neutral? Yes, we're at about neutral. Stacy? Unknowns are great on both sides. ((Inaudible)) versus COVID.

Operator
Next, we have a follow-up from Moshe Katri with Wedbush Securities.

Moshe Katri, Wedbush Securities
Just a follow-up, looking at the second half. Thanks for the color on the next few quarters. What should we look for in terms of EBITDA margins for Q3 and Q4? And then in that respect, looking into next year, stable, up, down? I mean, obviously, you do have to ramp. I'm assuming you will have to hire more people. Is this the right way to look at it in terms of early start-up costs? And while you're ramping, some of those new deals could actually pressure margins? Or how should we look at it?

Mike Bieber, Willdan
Yes, Moshe, it's a great question. And we don't know is the final answer, which is why we haven't given you guidance. But I'll give you the variables. And it's a story of the potential of LADWP ramping up in the second half of the year, which will improve margins significantly for the company versus the ramp-up of California work, which is actually more expense. So you're right that, that ramp-up will depress margins. Overall, the way our model looks is that you should expect EBITDA as a percent of net revenue to be in the mid- to high teens for the back half of the year and higher in Q3 and 4 than probably Q1. And that's sort of similar to what we saw this year. But those are the variables.

Operator
And as an additional reminder, star one if you have a question or comment. We'll move next to (Richard Robinson), a private investor.

Richard Robinson, Private Investor
What does the acquisition pipeline look like? And does Willdan have any plans to expand overseas with any international contracts?

Tom Brisbin, Willdan
Richard, where are you from? We've never talked to you before, I don't think.

Richard Robinson, Private Investor
Montreal.

Tom Brisbin, Willdan
Are you inviting us to Montreal?

Richard Robinson, Private Investor
Montreal, Canada. Yes.

Tom Brisbin, Willdan
Are you going to open the doors to let us into Canada?

Richard Robinson, Private Investor
I'd be glad to let you into Canada.

Tom Brisbin, Willdan
Okay. Mike, do you want to comment on that?

Mike Bieber, Willdan
Sure. The acquisition pipeline actually looks good, and we suspended discussions when COVID hit us last year. We have recently started to restart those discussions. So the pipeline looks good. We do not have any short-term plans to make an international acquisition. However, longer term, as we grow the company through $500 million and into the $1 billion mark, we would look towards those international markets for further expansion. And Canada is

a very likely place to go. We have a small operation in Canada right now, just a few people. And do some – probably less than 1% of our revenue right now is overseas. It's been increasing slowly. So that would be our strategy.

Operator
Once again, everyone, star one if you have a question or comment. That's star one. We'll pause for a brief moment. It appears we have no further questions in our queue. I'll turn it back over to you for any final or additional comments.

Tom Brisbin, Willdan
Yes, we have no further questions. And thank you very much for joining us today. And 2021, we all hope, will be a pandemic-free year. We're all going to get better. The business is going to go better. And we're looking forward to a much better year. So thank you.

Operator
Everyone, that concludes our conference call for today. Thank you all for your participation. You may now disconnect.