Willdan Group, Inc.
Second Quarter 2024 Earnings Call
August 1, 2024

<u>Presenters</u>
Al Kaschalk, VP
Mike Bieber, President and CEO
Kim Early, EVP and CFO

<u>Q&A Participants</u>
Craig Irwin - ROTH Capital Partners
Richard Eisenberg - Private Investor

Operator

Greetings, and welcome to the Willdan Group Second Quarter 2024 Earnings Call. At this time, all participants are in a listen only mode. A brief question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Al Kaschalk, Vice President. Thank you, Al, you may begin.

Al Kaschalk, VP

Thank you, Paul. Good afternoon, everyone, and welcome to Willdan Group's Second Quarter Fiscal 2024 earnings call. Joining our call today are Mike Bieber, President and Chief Executive Officer, and Kim Early, Executive Vice President and Chief Financial Officer.

This call builds on our earnings release we issued after market close today. You can find today's earnings release in the press release section of our website at ir.willdangroup.com. A copy of the slides that accompany today's call are located in the Events and Presentations section of the website. In addition, our Willdan investor report is available under Stock Information section of the website.

Management will review prepared remarks, and then we'll 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. Forward-looking statements involve certain risks and uncertainties and include non-GAAP measures. A more detailed safe harbor statement is on the cover of our first slide and our annual report on Form 10-K.

I will now turn the call over to Mike Bieber, Willdan's President and CEO, who will begin on slide two.

Michael Bieber, President and CEO

Thanks, Al. We had a record second quarter, exceeding consensus estimates and our own expectations. Contract revenue was up 18% organically and adjusted EBITDA was up 56% year-over-year. GAAP and adjusted EPS were up even stronger, both more than doubling year-over-year. During Q2, we had unexpectedly strong revenue across engineering and program management. We've also done a good job of converting revenue into free cash flow this year. Given our results for the first half of 2024 and our current momentum, we are raising our full year financial targets, which Kim will expand on later. The electric load growth macro trends strengthened during the quarter, and I'll talk more about that in a few minutes. I'm proud of our team for delivering another quarter above expectations.

Slide three is a quick reminder of where Willdan is positioned for the newer listener. Willdan helps transition communities to clean energy and a more sustainable future. We are just under 1,700 employees, comprised mostly of scientists, engineers, and other technical professionals. We have 53 offices across North America and have helped clients avoid emissions of 7.8 million metric tons of greenhouse gases. State and local government customers comprise 49% of our revenue, while utilities are 44%, and commercial customers are 7%. Demand for our services with all three customer groups is healthy. Our work for government clients is growing organically at a double-digit pace, and the outlook is positive. Our work for utilities is primarily under multiyear contracts and remains robust. Our work for commercial clients is largely related to energy usage at data centers. Willdan has focused on the data center market for many years because of its energy intensiveness, but the market has recently become more covered in the media due to AI load growth. We would like to expand our percentage of commercial work, both organically and through future acquisitions.

Onto slide four. Our upfront policy and data analytics work informs Willdan's strategy. In our upfront work, we are seeing particular demand for integrated resource planning and asset valuation work that is often associated with data center electricity load. In Engineering, we saw strong geographic expansion in Florida and Texas and continued demand from Southwestern city customers. In Program Management, we performed above our plan on utility programs and building energy programs for cities. I'll note that at Willdan, while revenue is skewed towards larger program management, our profit is delivered about equally from each of the three phases of work.

The right side of this slide provides two examples of how this business model works. More than 10 years ago, we began consulting to a New England investor-owned utility. That upfront consulting work led in part to a new software license sale in 2023 and then to a large energy efficiency program management contract earlier this year. The upfront work allowed us to understand the client's unique needs more thoroughly and craft more effective program management solutions.

The city of Paramount win in Q2 is another example of this model in practice. We have been providing consulting and engineering services to this California client continuously since 1973. We developed a thorough understanding of the city's needs, in this quarter, were then awarded an $18 million program management contract to oversee the design and construction of new solar, battery, and EV charging infrastructure, all aligned with the city's vision for energy transition.

On slide five. We had several notable wins this quarter. We won a study from Meta, formerly Facebook, on the emissions related to a voluntary clean energy procurement program that they've put in place. For the state of Virginia, which is the largest data center market in the U.S., we were awarded a program to study the grid impact for energy demand. This study includes the analysis of integrated 10 to 15 gigawatts of new generation and load into the Mid-Atlantic regional power grid by 2030. That's a lot of change. For Virginia, we are assessing the impacts to both the utility service providers and the rate payers. Cool project. For Glendale Water and Power located in California, we won a distributed energy resources study. I already mentioned the city of Paramount win in Q2. And lastly, for a Washington state municipal utility, we won an energy design assistance contract.

On slide six. Load growth is creating exciting new opportunities for Willdan, and we believe will help drive our growth for years to come. On the left side of this slide, for the first time in many decades, material electricity load growth has started to occur in the U.S. Experts are uncertain about the future speed and scale of this load growth, but there is widespread consensus now that it will occur and has already begun. The main drivers for this growth include the electrification of cities, buildings and transportation, the reshoring of industrial manufacturing facilities in the U.S., and electricity consumed by data centers. The map on the right shows that AI is expected to drive more power demand from data centers in certain pockets of the U.S. The D.C. area especially, the Southeast U.S., Midwest, and the West Coast are projecting far more rapid growth than average areas. Low electricity transfer capability between these regions is a key risk for reliability, particularly as electricity load shapes change.

Last quarter, I talked about double digit electricity price increases in California and New York, currently Willdan's two largest markets. The compounding effect of higher electricity prices and higher electricity load provides a multiyear catalyst for Willdan solutions. We're clearly excited about the energy transition capabilities that we've assembled: planning software, energy efficiency, and engineering. We plan to add even more capabilities to M&A in the quarters ahead.

Kim, over to you.

Kim Early, EVP & CFO

Thanks Mike, and good afternoon, everyone. Our second quarter results exceeded expectations. Strong earnings, combined with efficient working capital management, have reduced our debt leverage, improved liquidity, positioning us to invest more aggressively in future growth.

Slide seven shows the key metrics for our second quarter performance. Contract revenue was up 18% to $141 million, and net revenue, net of subcontractors and materials, increased 17% to $73 million. Adjusted EBITDA increased 56% over the prior year to $12.8 million or 17.7% of net revenue versus $8.2 million or 13.3% of net revenue a year ago. The second quarter earnings benefited from a slightly improved gross profit margin on the expanded volume and G&A expenses, which increased at a slower pace than our revenue growth. With reduced net interest costs and a significantly lower tax rate than the previous year, our adjusted EPS more than doubled to $0.55 per share, $0.33 on a GAAP basis, up from $0.03 the prior year. The second quarter results were favorably impacted by growth in municipal engineering and program management revenues derived from the strong and increasing backlog of new contracts and by the acceleration of utility program management revenues compared to last year when the utility revenues were heavily back-end loaded into our fourth quarter. As a result of earlier work authorizations, much of that 2023 fourth quarter revenue surge has been brought forward into the first half of the current year and will thus reduce the kind of year-end revenue and earnings spike we experienced last year.

Lower leverage and higher cash balances reduced net interest costs and discrete impacts related to stock-based compensation and energy efficiency building reductions aided in lowering the effective tax rate to result in the bottom-line improvement for the quarter compared to last year. We expect our second half effective tax rate to also be favorably impacted by additional deductions derived from these discrete items.

Slide eight displays the key metrics for the first half of the year. Contract revenue was up 19% over 2023 to $264 million, while net revenue increased 14% to $141 million. With the gross profit margin only slightly lower than last year on the expanded volume and continued operating leverage from the slower-growing G&A expenses, adjusted EBITDA increased 32% to $23.9 million or 16.9% of revenue for the six months compared to $18.1 million or 14.6% of net revenue for the first half of last year.

The reduced net interest expense and the lower effective tax rate enabled adjusted EPS to grow by 64% to $0.95 per share, $0.54 on a GAAP basis, up from $0.10 the prior year. Again, significantly higher municipal engineering and program management revenue and a smoother acceleration of utility program revenues drove the improved results for the period compared to 2023.

On slide nine, the strong earnings and focused working capital management efforts led to continued improvement in our balance sheet ratios. Net debt is down from $75 million at year-end 2023 to $50 million at the end of June, resulting in a reduction in the net leverage ratio (total debt less cash), to 1.0x adjusted EBITDA at the end of June, down from 1.6x in December. Despite the double-digit revenue growth for the year, noncash working capital declined since year-end and contributed to the $28 million in net cash provided from operations through the first half of the year, up from $19 million a year ago. Our $50 million untapped line of credit and $44 million cash balance give us a solid platform of liquidity to finance future growth.

With slide 10, in summary, our second quarter and year-to-date results surpassed expectations, reinforcing our optimism about the future and opening doors for accelerated growth, including strategic opportunities through M&A. We're thus raising our guidance for the full year as follows:

- net revenue between $280 million and $290 million
- adjusted EBITDA between $50 million and $52 million
- adjusted diluted earnings per share of between $2 and $2.10 per share
- These numbers assume an effective tax rate of 14% for the full year and 14.2 million shares outstanding.

Operator, we're now ready for questions.

Operator
Thank you. We'll now be conducting a question and answer session. If you would like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset

before pressing the star key. One moment please, while we poll for questions. Thank you. Our first question is from Craig Irwin with ROTH Capital Partners. Please proceed with your question.

Craig Irwin - ROTH Capital Partners
Good evening. Thank you for taking my questions. So Mike, Integral Analytics has made a material contribution, sort of lumpy contribution in the past, but it looks like this year things are a little bit more even on a quarterly basis. Can you maybe update us on what's changed in the character of this business? Did we see similar revenue in the second quarter to the first quarter? Do you think that some of the volatility in earnings related to Integral Analytics might potentially be behind us and really more of a source of upside over the next number of quarters?

Michael Bieber, President and CEO
Yeah, good question, Craig. I do think it is smoother now. We've worked consciously to do that. So it's smoother than last year. We saw early contract wins in Q1 of this year. Part of the reason that it is smoother, and it will be smoother in the future, is that we're doing more add-ons and small additions to existing licenses that we've already sold.

We've also partnered quite a bit with E3 on the services side to pair services with software licenses. So you're right, it is smooth. It's a conscious effort we've made, and it should remain so in the future. Having said that, there will always be some lumpiness due to accounting requirements. When we sell a large license that is capitalized by the customer, we have to recognize all of that license revenue upfront. So that's what makes it lumpy, it'll remain somewhat so, but less than in the past.

Craig Irwin - ROTH Capital Partners
Excellent. So you mentioned E3. I guess most of the people on the call already know that E3 consulted to essentially every zero carbon mandate program in the country, right. All these states that are adopting mandates, giving them logical paths of how they can get there and what they can support with policy. Now I think the states have a bigger problem with some of this load growth and some of this economic growth we're seeing in different areas. Do you think that the track record that E3 has developed, looking at some of these advanced technologies (inaudible) to handle some of the structural problems in the grid, do you think that E3 has a potential uptick in consulting activity and project proposals for really what we're going to see is sort of reserve margins eroding quickly?

Michael Bieber, President and CEO
You're right, Craig. I don't know that they've consulted to every state, but they certainly are well known in this area, maybe the most well known in the United States for doing these types of big

energy and carbon studies at the state level and for major cities and major pieces of the power grid. Virginia, the project I mentioned is another example of that. We just picked up another one. So we're well known for that. That area of business is doing exceptionally well. So I think, yeah, there is some upside, especially as you look out over the next three years, states and utilities are going to have to grapple with the big changes in load that were not expected. Most of their enterprise-wide planning that has been done over the last five years is being rethought now and rethought quickly. So this is a rapid change. I think there is more upside to that, and it should be good the next several years, actually.

Craig Irwin - ROTH Capital Partners
Thank you. So my last question before I jump back in the queue. Meta, this emission study for voluntary clean energy procurement, can you help us understand sort of the specifics of the project and the timeline for revenue and whether or not you see similar opportunities for other leaders in clean energy adoption?

Michael Bieber, President and CEO
Yeah, this is just one example project for work we're doing for big tech largely in the Silicon Valley and up and down the West Coast. We've got several projects like this. You know, it's a study project right now, and this particular project is not that large. Some of them are large. Work we do for, you know, Cisco and Microsoft and other big tech companies is becoming more important to us. And so this is a study that's about six months long. Good project.

Craig Irwin - ROTH Capital Partners
Excellent. Well, congratulations. Strong progress across the board. I'll hop back in the queue.

Operator
As a reminder, if you'd like to ask a question, please press star one on your telephone keypad. Our next question is from Richard Eisenberg (ph), private investor. Please proceed with your question.

Richard Eisenberg - Private Investor
Yeah, good afternoon, and congratulations on a great quarter. Is there opportunity to do business with the big data center companies like Microsoft and Amazon in the future since you're doing business now with Facebook? Thank you.

Michael Bieber, President and CEO
Yes, there is. And we are doing businesses with those types of customers. We actually have been for a number of years, so this is not new for us. We started out with AT&T. They were early entrants and owner of data centers around the country. And we do quite a bit of work for AT&T

today. We've expanded that list to include most of the major data center, both owners and developers. We work for both sides there. So there's definitely that opportunity. Some of that work is confidential, so I'm not going to walk down the list of customers. But we work for most of them. It's a rapidly expanding market for us.

Richard Eisenberg - Private Investor
Okay. Also, are there going to be any possible acquisitions this year or more likely in 2025?

Michael Bieber, President and CEO
Great question. And we would like for them to be this year. There's never any guarantees. You can't predict the timing of those, but we've been working on this all year long. We started last year and we have some mature opportunities that we're working on right now that we're really excited about. Very cool, interesting capabilities that we hope to be adding soon. I hope they're this year, we'll see.

Richard Eisenberg - Private Investor
Okay. Thank you. Congratulations again. Thank you.

Operator
Thank you. There are no further questions at this time. I would like to hand the floor back over to Mike Bieber for any closing comments.

Michael Bieber, President and CEO
Thanks, Paul. To our customers, employees and investors, thank you for your support. And we will talk to you again after Q3. Thank you.

Operator
This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.