Willdan Group
Third Quarter 2024 Results
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<u>Presenters</u>
Al Kaschalk - VP of IR
Michael Bieber - President & CEO
Kim Early - EVP & CFO

<u>Q&A Participants</u>
Craig Irwin - ROTH Capital Partners
Jay McCanless - Wedbush Securities

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

It is now my pleasure to introduce Al Kaschalk. Thank you, Al. You may begin.

Al Kaschalk
Thank you, Julian. Good afternoon, everyone, and welcome to Willdan Group's third 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.

Our conference call remarks will include both GAAP and non-GAAP financial results. Reconciliations between GAAP and non-GAAP measures can be found in today's press release and in the presentation slides, all of which are available on our website. Please note that year-over-year commentary on variances on revenue, adjusted EBITDA and adjusted EPS discussed during our prepared remarks are on an organic basis.

We will make forward-looking statements about our performance. These statements are based on how we see things today. While we may elect to update these forward-looking statements at some point in the future, we do not undertake any obligation to do so. As described in our SEC filings, actual results may differ materially due to risks and uncertainties.

With that, I'll hand the call over to Mike.

Michael Bieber
Thanks, Al. We had a record third quarter, exceeding consensus estimates and our own expectations. Contract revenue was up 19% organically, and adjusted EBITDA was up 50% year-over-year. Adjusted EPS doubled, and GAAP EPS was up more than four times year-over-year.

During Q3, all lines of business were strong. We continue to do a good job of converting revenue into free cash flow. Through three quarters, we have generated $2.30 of free cash flow per share, an outstanding result. I'm proud of the team's consistent excellent performance.

Given our year-to-date results and our continued momentum, we are raising our full year financial targets, which Kim will expand on later. We are confident in Willdan's growth trajectory as we support our clients in meeting critical energy efficiency and decarbonization goals. Demand for electrical power is rising, along with a heightened focus on energy security and expanded grid investments.

On Slide 3, Willdan helps transition communities to clean energy and a more sustainable future. For the first time, we are now over 1,700 employees, comprised mostly of scientists, engineers and technical professionals. We have 53 offices across North America and have helped clients avoid emissions of 7.8 million metric tons of greenhouse gases. Willdan's work is a significant contributor to U.S. greenhouse gas reductions, particularly in the densely populated coastal states.

Commercial customers comprise 7%, government customers are now 50% and utilities are 43% of our revenue. Demand for our services with all three customer groups is healthy. Our work for commercial customers has largely been related to energy usage at data centers. AI-driven load growth is providing Willdan with many new commercial opportunities to help technology clients navigate electricity constraints. We would like to add additional acquisitions that strengthen our capabilities with commercial customers.

Our work for government clients is growing organically at a double-digit pace and has remained surprisingly strong all year, and the outlook is positive. Our work for utilities is primarily under multiyear contracts and remains robust.

I also want to mention California's energy affordability crisis. Since 2019, PG&E's electricity rates have risen 87%, SCE has risen 79%, and SDG&E has risen 41%. These electricity rate increases have been driven substantially by wildfire preparedness costs due to climate change. The increase has made saving electricity in California more cost-effective. Willdan is the largest provider of energy efficiency services to California utilities, and those programs are growing rapidly.

On to Slide 4 - 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 on projects 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.

The right side of this slide provides an example of how the business model works. More than 10 years ago, E3 started decarbonization and energy consulting work for New York City. That work led to Willdan developing the implementation plan from Local Law 97, a decarbonization strategy for many of New York's largest buildings. This year, we have significantly expanded our work with the New York Power Authority, NYPA, to implement those plans developed years before. NYPA has grown to become Willdan's fifth-largest client this year. We are managing NYPA programs to decarbonize, electrify and make New York's public facilities more energy efficient.

On to Slide 5 - we had several notable wins this quarter. We won Phase 2 at Clark County School District, the fifth-largest school district in the country. This $103 million contract is for facility energy upgrades. With SCE, we were awarded a contract expansion for our commercial energy optimization program. In New York, we were awarded a $9 million public building energy efficiency contract with NYPA, one of several NYPA projects we've been awarded this year. We won several contracts in civil engineering, including two contracts with the city of Phoenix and Bellflower. Recently, we have also won several regional and state climate action and TMD studies.

Turning to Slide 6, we expanded our highly differentiated commercial energy consulting business through the acquisition of Enica Engineering. Enica is a trusted engineering adviser, providing energy, operations and building automation solutions. Their client base includes global pharmaceutical companies, Regeneron and Novartis, private health care providers such as Sloan-Kettering, and higher education research institutes, such as NYU. Consistent with our strategy to expand our commercial capabilities, Enica is expected to generate about $10 million in revenue in 2024 and be accretive to 2025 margins, earnings and EPS.

On Slide 7 - electricity 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's widespread consensus now that higher load growth 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 powering AI.

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 Southeastern United States, Midwest, and the West Coast are projecting far more rapid growth than average areas. Low electricity transfer capabilities between these regions is a key risk for reliability, particularly as electricity load shapes change.

I'm excited to share that we are nearing the release of a significant enhancement to our LoadSEER grid planning software. We have integrated artificial intelligence into LoadSEER's new API and are poised to launch new products that are quicker to deploy and scalable beyond the large investor-owned utilities. This advancement allows us to penetrate new markets, creating value for smaller co-op utilities, municipalities and virtual power plant owners. The new AI version also provides computational power for complex scenarios not possible to model today.

We're excited about the energy transition capabilities that we've assembled- planning, software, energy efficiency and engineering. We plan to add even more capabilities through future acquisitions in the quarters ahead.

Kim, over to you.

Kim Early
Thanks, Mike, and good afternoon, everyone. Slide 8 shows our key metrics for our third quarter performance. We delivered $158 million in contract revenue, up 19%, and net revenue, net of subcontractors and material, of $76 million, an increase of 16%.

Adjusted EBITDA increased 50% over the prior year to $15.2 million as we benefited from higher utility revenues and project management activities as well as G&A expenses, which increased at a slower pace than our revenue growth.

With reduced net interest costs and an exceptionally low tax rate, our adjusted earnings per share nearly doubled to $0.73 per share. The third quarter results were favorably impacted by growth in municipal engineering, project management revenues and expanded utility program management revenue. Lower leverage and higher cash balances reduced net interest costs and discrete impacts related to building energy incentives and stock-based compensation aided in lowering the effective tax rate for the quarter to only 2%, driving a substantial bottom line improvement for that quarter compared to last year.

Turning to Slide 9, for the nine months to date, we generated $422 million in contract revenue and $217 million in net revenue, up 19% and 15%, respectively. The revenue mix resulted in a slightly lower gross profit margin versus last year. But higher activity from our construction management projects, expanded utility programs and higher municipal engineering services resulted in a 38% increase in adjusted EBITDA to $39.1 million for the nine months compared to $28.2 million last year. The increased adjusted EBITDA, reduced net interest expense and the lower effective tax rate enabled adjusted earnings per share to grow by 79% to $1.70 per share.

From a balance sheet perspective on Slide 10, our net debt balance at the end of the quarter was $39 million, down from $75 million at year-end 2023, reflecting the strong earnings and efficient working capital management, resulting in a net leverage ratio, meaning total debt less cash, of 0.7 times the adjusted EBITDA. This is down nearly one full turn from the 1.6 times in December 2023.

Double-digit earnings growth and an increase in non-cash working capital contributed to $38.6 million in net cash provided from operations through the first nine months of the year, up from $24.1 million a year ago. Our total liquidity was $103 million and included our $50 million untapped line of credit and $53 million cash balance.

We've begun to deploy this liquidity to enhance our growth and future potential through acquisition as exemplified by the acquisition of Enica Engineering. We're excited about the expanded skills for our customer base and the potential synergies that Enica brings to our Energy segment and the prospects for additional acquisitive investments to broaden and strengthen Willdan.

In terms of our guidance on Slide 11, recall that the fourth quarter of 2023 was a record quarter for Willdan in terms of the revenue and EBITDA. In that quarter, we delivered on our clients' request for expanded energy efficiency services, which we estimated would be a $15 million headwind to comparisons of 2024 and 2023 Q4 net revenue and a $3 million headwind to those same adjusted EBITDA comparisons.

Based on our year-to-date performance and the continued momentum, we are raising our full year guidance. We now expect net revenue between $285 million and $295 million, adjusted EBITDA between $52 million and $54 million and adjusted diluted earnings per share of between $2.15 and $2.25, assuming a full year tax rate of about 14%, and 14.2 million shares.

Operator, we're now ready to take questions.

Operator

Thank you. We will 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 to remove yourself from the queue. We do ask that you please limit yourselves to one question and one follow-up. For further questions, you may reenter the queue. Thank you. One moment while we poll for questions.

And our first question comes from Craig Irwin, ROTH Capital Partners.

Craig Irwin
Hi. Good evening. Thank you for taking my questions. So Mike, first, I should say congratulations, another really solid quarter here. Most investors right now are looking to next week and the uncertainty around policy in North America. Energy policy could pivot away from renewables, or maybe a little bit more enthusiasm could be seen actually across the federal customer base and the states as well in the other potential outcome.

Can you maybe project for us the sensitivity of Willdan to federal policy, or do you see more of an impact from state policy and state support for different programs? And if we did see a change in administration, is there maybe an incremental opportunity on some of the consulting work that you do as grid planning and renewables planning maybe takes a different path?

Michael Bieber
Yeah, Craig. Great question, and timely. We have always said that state policy dominates the type of work that we do. And it actually dominates most of the electricity decisions made in the United States right now. So the public utility commissions in those states make those types of decisions.

With regard to federal policy, we've sort of seen this show before. Business was good under the Trump administration, and business was good under the Biden-Kamala Harris administration. So we've seen them both; business was healthy under both. You're right, though. The dominant amount of policy fluctuations we see really affect at the state level and not the federal level.

Craig Irwin
Excellent. So my next question is another big picture question. Rising energy prices are something on all state governors' minds, right? If they're Republican or Democrat, really doesn't matter. Energy costs are pressuring consumers. Are you seeing any change in attitudes around utility commissions as far as holding utilities accountable for the implementation of their energy efficiency programs and efforts to control prices, particularly given the very strong load growth that we're seeing from AI and data center demand?

Michael Bieber
Yeah, it's a big issue with the public utility commissions. For the first time, we've seen a number of rate cases that were not approved by the PUCs. We've seen that around the country, where rates were proposed to increase and the PUC pushed back. We've also seen increased focus on saving electricity, as you mentioned. The importance of electrical efficiency becomes more valuable as electric prices rise. So places like California, as an example, now have electricity prices just behind Hawaii. They're the second-highest in the nation right now. And so the value of energy efficiency in California increases. We're seeing that around the country, as well.

Craig Irwin

Okay. And then my last question, if I may - I know it's a little tricky to -- when you haven't put out guidance for '25, right? But everybody is going to be scratching their heads and saying you had well over 10% growth in '24. And you've always been careful in the way you give guidance and spoken pretty much consistently about a growth outlook that I think is achievable. Is it possible we see something north of 10% growth in '25 on an organic basis? I mean, is there potential for similar results, similar growth in net revenue for '25 to what we actually saw reported in '24 -- or it looks like we'll see reported in '24, I guess is the way to clarify.

Michael Bieber
I'll stick with the answer that we've been providing all year long, which is, if you're modeling 2025, assume a high single-digit organic growth rate - 7%, 8%, 9% seems more reasonable. We haven't changed our tune on that.

Having said that, yes, it's possible that we could exceed that. We'll enact guidance really five months from now in early March of next year. So we haven't done the bottoms-up yet. We don't quite know exactly what that looks like. So we'll stick with our answer of high single-digit organic growth rate. I think that's a more reasonable assumption and gives us a chance to beat that as we have all year this year. It's been a great year. We're on a tear, and we're doing exceptionally well.

Craig Irwin
Well, I look forward to a continuation of this trend, and congratulations. It's just another really solid quarter.

Michael Bieber
Thanks, Craig.

Operator
Thank you. Our next question comes from Jay McCanless, Wedbush Securities.

Jay McCanless
Hey, good afternoon. Thanks for taking my questions. The first one, I was wondering if you guys could delve a little more into the Florida and Texas comments you made about halfway through the prepared comments. And knowing especially in Florida where they're still trying to rebuild, I guess maybe could you size up those opportunities and what parts of those different states you're talking to at this point?

Michael Bieber
Yeah, great question, Jay. To put this in context, five years ago, between Florida and Texas, I want to say we had maybe 10 employees at Willdan working. Today, that number is in excess of 50, and it's our fastest-growing area. We are hiring in both of those states.

There's enormous growth at the state and local level for the services that we provide, around Texas, providing work around the state, and in Florida, most of that's in Northern Florida right now, up around the Orlando area. We're doing a bit of work in Florida under framework contracts to help rebuild after the last two hurricanes. We're seeing some opportunities there under existing contracts that we already had in place with several of the cities there. It's a relatively small part of the business right now, but it's rapidly growing, and we're hiring in those states.

Jay McCanless
That's great. And then maybe talk also about the – apologize if I'm not pronouncing this correctly -- but the Enica acquisition, what other types of acquisitions might be on the horizon? And I think you said for Enica, this helps expand your opportunities in commercial. Is that kind of the line you want to be heading down is more opportunities there, especially with AI and which you talked about with some of the data warehouse centers coming online and requiring more power?

Michael Bieber
Yeah, another great question, Jay. We're really happy that the Enica team has joined us. 7% of our revenue right now is focused on the commercial sector. It's underweighted in our portfolio. We'd like to further diversify by increasing that commercial area. Enica will help with that by a percentage or 2.

We would like to add other acquisitions that focus specifically on the data center opportunities we're seeing. And we've got a good pipeline of those. So more news to come on that. It's an area of investment, one of the several areas we'd like to invest in. It's front of mind, though, because that's only 7% of the business, and we're seeing enormous opportunity there with some of the big tech players and the work that's done around providing power to these large data centers.

Jay McCanless
Great. And then could you talk to -- and congrats on raising the guidance. Just maybe again walk through what you're thinking in terms of where that revenue is -- the revenue growth is going to come from? Is it mostly going to be on the government side? Or maybe just give us a little more depth there on how those targets are moving up, please.

Michael Bieber
State and local has actually been the standout in terms of customer segments thus far. I think that's going to continue. We're also going to have a very strong quarter this year in Q4 with utility revenue.

Kim, can you think of anything else there?

Kim Early
No, that's -- I think that's right. It's pretty broad-based. We have remained growing faster in that state and local government side, where we're working directly for the cities, both in terms of the engineering work that we're doing and the energy efficiency work that we're doing in the buildings. So that has been a standout. But it's pretty broad-based across all of our customer base.

Jay McCanless
Okay, great. That's all I had. Thank you.

Operator
Thank you. Once again, if you'd like to ask a question, please press star, one on your keypad. You can press star, two to remove yourself from the queue.

Okay. Well, if there are no further questions at this time, I would like to turn the floor back to Mike Bieber for closing remarks.

Michael Bieber

Great. I just want to thank everyone for following us and being a shareholder of Willdan. We'll talk to you when we announce our Q4 earnings, and that will be in March of next year, along with our 2025 guidance at that point. So talk to you then.

Operator
Thank you. This does conclude today's teleconference. We thank you for your participation. You may disconnect your lines at this time.