WILLDAN GROUP, INC.
FQ3 2020 Earnings Call
November 5, 2020

CALL PARTICIPANTS

EXECUTIVES – WILLDAN GROUP

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

ANALYSTS / INVESTORS

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

PRESENTATION

Operator

Please stand by. Good day ladies and gentlemen. Welcome to the Willdan Group Third Quarter 2020 conference. Today's call is being recorded. At this time, I would like to hand the conference over to Mr. Al Kaschalk. Please go ahead, sir.

Al Kaschalk

VP, Investor Relations

Thank you, (Lisa). Good afternoon, everyone, and welcome to Willdan Group's Third Second Quarter Earnings Call. Joining our call today are Tom Brisbin, Chairman of the Board and Chief Executive Officer; Stacy McLaughlin, Chief Financial Officer; and Mike Bieber, President of 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 and updated 4Q3 results in Investors section of our web site, willdan.com. Management will review prepared remarks, and then we will 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 Form 10-K for the year ended December 27, 2019 and subsequent quarterly reports on Form 10-Q. The company cautions investors not to place undue reliance on the forward-looking statements made during the course of this conference call. Willdan disclaims any obligation and does not undertake to update or revise any forward-looking statements made today.

In addition to GAAP results, Willdan also provide 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 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 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-Q for the quarterly period ended October 2 in the next few days. In today's prepared remarks, Stacy will provide a review of our third quarter financial results, discuss our balance sheet and related cash flows. Stacy will be followed by Tom who will provide a brief commentary on our business environment and Q3 results, opportunities to cash our operating deficiencies as we make permanent changes to the way we do business as we evolve from the pandemic, and then conclude with a business development update, including California IOU procurements. We'll then open the call up for Q&A session. I will now turn the call over to Stacy.

Stacy McLaughlin
Chief Financial Officer

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

Since our last earnings call, the overall business environments did not materially change but our operations continued to be impacted by the COVID-19 pandemic, albeit to a lesser extent than in the second quarter. All contracts have restarted except for the Los Angeles Department of Water and Power Small Business Program. With no contracts scheduled, net revenue increased by 18% sequentially. Overall, our third quarter performance was better than our internal plan. Tom will provide additional details related to Q3 performance and new contract awards during his prepared remarks.

Total contract revenue for the third quarter of 2020 decreased 11.1% to $104.5 million from $117.5 million for the third quarter of 2019. The decrease is primarily due to the suspension of the LA DWP Small Business Program. Net revenue was $51 million. A slight increase from $50.8 million in the year ago quarter. While net revenue in our energy segment was unchanged, net revenue in our engineering and consulting segment increased less than 1%. Direct cost of contract revenue was $69.9 million in the third quarter of 2020, a decrease of 15.7% or $82.8 million in the same period last year. The decrease was primarily as a result of decreased contract revenue from our direct install program for small businesses in our energy segment, partially offset by additional direct costs of contract revenue related to our acquisition of E3.

Our direct cost of contract revenue was 67% of our total contract revenue in the third quarter, up from 65% in the second quarter of 2020 but down from 71% in the same period the prior year. The difference in each period primarily reflects changes in the mix of work and the degree to which subcontractors are equalized.

Total general and administrative expenses for the third quarter were $33.1 million compared to $33.4 million for the prior year period. The net decrease in total, general and administrative expenses was due to lower companywide travel expenses and we conduct business more efficiently and lower amortization of intangible assets derived from prior acquisitions.

These lower expenses were partially offset by higher personnel and facilities costs attributable to the acquisition of E3. In response to the COVID-19 pandemic, the company has taken and will continue to take measures intended to help minimize the risk of COVID-19 to its employees, including requiring the majority of its employees to work remotely, suspending non-essential travel and restricting in person work related meetings.

Adjusted EBITDA was $11 million for the third quarter of 2020 compared to $11.6 million for third quarter of 2019. Adjusted EBITDA as a percent of revenue was 21.6% for the third quarter of 2020 compared with 22.8% for the third quarter of 2019. I would like to point out that contract revenue was down 11% due to COVID suspension but adjusted EBITDA in the quarter was only down 5% from the prior year period. We have continued to do a good job of controlling cost in the quarter. Third quarter net interest expense was in line with the same period last year, despite the higher debt borrowings, our borrowing rate reduced to approximately 200 bases points versus the year ago period due to reductions in a one-month LIBOR.

For the three months ended October 2, 2020, we recorded an income tax benefit of $1.6 million versus an income tax benefit of $0.4 million in the same period last year due to increased tax deductions and tax credits. We had debt income in the third quarter of 2020 of $2.6 million or 21 cents per diluted share compared with net income of $0.4 million or 4 cents per diluted share in the same period last year.

On an adjusted basis, our net income was $8.5 million or 68 cents per diluted share. The most significant adjustments from our GAAP net income were stock based compensation and intangible amortization, which are both non-cash items. 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. We continue to see improvements in this area and for the nine-month period ended October 2, 2020. We generated $26.9 million in cash flow from operations, a record level for the company.

During the same period last year, we generated $8.3 million in cash flow from operations. As of October 1, 2020, we have $115.3 million outstanding on our credit facility. We have no borrowings under our revolving credit facility with $50 million available. Our net debt to adjusted EBITDA trailing 12-month leverage ratio as measured by the terms of our credit facility was 3.1 times.

I want to take a moment to provide you with some additional details about our new term outlook. First, our business development efforts remain robust with proposal activities for new programs continuing to advance. Second, our 2021 budgeting process in underway and we expect to be in a position to provide you with additional details in March 2021.

Third, last quarter we expected the Los Angeles Department of Water and Power Program to resume in the fourth quarter2020, but we no longer expect that to occur due to the high rates of COVID-19 in Los Angeles County. And lastly, we are anticipating a decrease in adjusted EBITDA when compared to Q4 2019 due to the large software sale recorded at the end of last year, combines with the impact of COVID-19 outbreaks and actions that contain the virus or treatment impact.

The fourth quarter 2020 adjusted EBITDA is expected to be down approximately 15% from the third quarter of 2020 results. In terms of business expense, we estimate fiscal 2020 to be approximately $5.5 million, down from $6 million previously communicated to you.

The pandemic has taught us several things over the past seven months. One of which is the ability to work efficiently remotely. As part of our long-term strategy we will be adding a focus on real estate costs. Our average lease duration is three to five years and we spent $7.2 million or 4.8% of G&A per year on real estate expenses. As these leases expire, we are setting a goal to reduce facilities costs by 25% on a per head count basis. When complete this should result in a 100 bases point margin improvement. I'd now like to turn the call over to Tom.

Tom Brisbin
Chief Executive Officer

Okay, thanks Stacy and good afternoon everyone. Overall, we performed well during the third quarter. Given the reopening activity in nearly all of our markets, I will provide highlights on our third quarter results, how our business model is emerging from this year's pandemic and conclude by sharing insights into our business development pipeline.

During the third quarter of 2020, our business continued to be impacted by COVID-19. Third quarter revenue in the energy segment was up 25% sequentially. The small business program in the LADWP territory remains on lockdown. During the third quarter, LADWP shift of resources to the Los Angeles Unified School District provide some relief to the program. The shift allowed us to implement energy efficiency services into nine schools. We now expect the entire program to resume early in January 2021. Our business volume in New York improved during the quarter, as all utility programs fully ramped. The city is open, customers are signing up, incentives have increased, and contractors continue to run fast, as customers capture a better deal.

We entered 2020 with an increased focus to improve our cash conversion cycle and reduce our debt levels. As Stacy mentioned, we generated the highest level of cash flow from operations for a nine-month year to date period in the company's history. We will continue to work on cash flow, to invest in the business and reduce debt.

During the second quarter conference call I discussed how the company took all appropriate actions to limit the effects of COVID-19 financial impact. These actions include furloughs, layoffs, salary reduction, board fee suspension, suspension of 40K match funds and stopping all discretionary spending. In the third quarter, we rehired a larger percentage of the furloughed employees and continue to add back where warranted. We also restored salaries and benefits for employees and expect to resume company matching of 401K plans during the fourth quarter.

Willdan has learned this year that we can permanently operate our business virtually, more efficiently and with a lower cost structure. While still early, we see signs of holding on to cost savings and operating efficiencies. As projects have resumed, we have been extremely disciplined in bringing back employees and controlling other direct costs. The pandemic has allowed us to integrate technology at our project job sites. We have used technology to develop and implement effective protocols to keep our employees safe. For instance, in some cases, we are able to do a virtual audit – these are virtual energy audits – of a building to look for energy efficiency measures without entering the facility. We are planning to publish our initial company sustainability report in the fourth quarter of 2020 and plan to update this report annually. This report will also address diversity and we'll be able to track our progress.

Despite the impact of COVID-19, we continue to see customers actually conducting procurements. We finally have some information that we can share on the California IOUs. First, we thank the IOUs for meeting their schedules and second for awarding Willdan a significant amount of work. We have signed a total of 781 million in new California IOU contracts to date. These six contracts are three to five years in duration and on a weighted average basis represent 150 million per year in incremental revenue. This is, of course, based on successful execution.

The new work will begin slowly and pick up in the back half of 2021. Four of the six executed contracts are waiting California Public Utility Commission approval. Two have been approved. We will announce more detail on the contracts when the TUC approves the contracts and the utilities allow us to announce them. In summary, the six California energy efficiency 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 to the program or programs that can ramp, execute project milestones, and deliver required savings.

Even though the market potential for these programs has been cut due to the pandemic, Willdan still won more than the incremental dollar amount that we told you during our secondary offering. We stated then that if we could win more than 100 million per year in incremental revenue, we'd give ourselves an A. About 150 million per year has been awarded to us thus far. We have additional California IOU proposals still outstanding. Thus, we will provide you additional details when it doesn't compromise our competitive position. Beyond the California IOU Procurement Process, business development and proposal efforts remain robust.

Our engineering segment remained strong during this quarter and the opportunity pipeline is growing. Within the energy segment we see demand for energy efficiency services, including grid modernization. For example, we we've kind of moved from California to the east coast now with New Jersey. We're looking at at least 25 million per year for small business and other commercial demand site management programs. Pepco in Maryland is 50 million per year designed to implement small business and combine heat and power programs. And (unintelligible), the New York City Housing Authority is 90 million over a two-year period for (unintelligible) of steam boiler plants.

On behalf of our board of directors, management, and shareholders we would like to thank our employees and customers for their resiliency, dedication and hard work during this pandemic. I also want to thank our teams for their commitment to developing and the implementing effective protocols to keep our employees safe and projects running. The health and safety of our employers in our first priority and I am proud of what we've accomplished. Operator, we are ready to begin the question and answer session.

QUESTION AND ANSWER

Operator

Thank you. And if you would like to ask a question, please signal by pressing star 1 on your telephone keypad. If you are using a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment. Again, that is star 1 to ask a question. And we will take our first question from Craig Irwin with ROTH Capital Partners. Please go ahead.

Craig Irwin

Roth Capital

Good evening and thanks for taking my questions. Tom, 781 million, that is a beautiful number. Congratulations, I know you guys have been working really hard on this for years and it's a big accomplishment.

Tom Brisbin: Thanks Craig. You're right, we have been, and it is a great number.

Craig Irwin: So, I wanted to…

Tom Brisbin: I expect you to ask more questions.

Craig Irwin: Yes, no, I have a bunch more.

Tom Brisbin: Yes.

Craig Irwin:

I wanted to verify that we're roughly at the 40% mark of the $900 million opportunity. And using your comments about the weighted average of $150 million a year, over the duration of the three to five years these contracts represent, you know, is this basically 150 million out of 360 million that was awarded? Meaning, a 40% plus win rate of available scope.

Tom Brisbin:

Okay. That's a little hard to answer. So, you want to answer win rate, you want to answer how much they've awarded. (Unintelligible).

Craig Irwin:

There's a couple questions in there. Yes. So, are the awards done from the procurements you've already submitted for this year? Do we have a final tally or are there potentially other awards that can come too?

Tom Brisbin:

There are a few other awards for us. They're not as big. But let me give you a little bit of an answer here. We proposed – these are rough numbers – about 1.2 billion. Those budgets were reduced by the IOUs to about 903 million. So there was an effect that took place due to the pandemic, due to the lateness of the procurement. They adjusted their awards. All right? So…

Craig Irwin: Yes.

Tom Brisbin:

…of the 900 that was one thing that took place. So, of the remaining 903 million, we won 793 million or 88% of what we went after. Now, the next part of your question is what's left?

Craig Irwin: Yes.

Tom Brisbin:

Yes. To our understanding from public information and what we know – let me get to that page. I knew you'd go into this. So, we think the total awards either pending or publicly available will be about 1.5 billion. We'll then…

Craig Irwin: Got it.

Tom Brisbin:

… (unintelligible) awards either awarded or pending will be about 825 million or 54% of the total available funded.

Craig Irwin:

Wow. That's pretty fantastic win rate, so congratulations. So how should we think about this turning on for you as far as revenue? In the release and in your prepared remarks you were very clear this doesn't start today. This comes on incrementally as these jobs ramp up in 2021. You know, do we see a revenue impact in the first quarter of '21, you know, proportionately, you know, how far do we get towards that $150 million run rate by the end of the year? How should we be looking at the ramp?

Tom Brisbin:

I would say nothing in the first quarter, a little in the second. Third and fourth, we ought to be at about – we won't even bid half I don't think. I'm looking at Mike. This is a guess guys.

Mike Bieber: Yes, it's a guess. By the fourth quarter we don't think we'll be fully ramped up.

Tom Brisbin: No.

Mike Bieber:

And certainly not to the maximum. And revenue will follow, you know, it'll lag with the actual work we're doing by whatever, 60 to 90 days. So, (unintelligible).

Craig Irwin:

Got it. So, then the margins available on this work, I know you were in long negotiations with both and the commission here. Should we expect something similar to the corporate average? You know, maybe if we take out software the corporate average. You know, is this something that's going to be pretty typical as far as profitability for you?

Tom Brisbin: We still have competitions going on Craig and we've said about all we can say.

Craig Irwin:

Got it. Got it. Then the other side of the business I wanted to ask on is integral analytics. You guys are one of the few out there with a really credible solution. Got the greenlight from a bunch of commissions but we haven't necessarily seen all of the contracts. I know there's a lot of fish in the pond, to use an analogy we all like. How should we be thinking about the contribution from integral analytics as we head into the back end of the year? Is growth there a focus in 2021? I know you have been putting resources in there, do you feel like those resources are yielding results?

Mike Bieber:

Craig, I think it's going well, and we have been investing there. And, by comparison, we only had one large contract in the pipeline, (unintelligible) whatever, multimillion excel contract last year. Now we have three large contracts in the pipeline. So, that's good. I think it's a pretty good probability that one of those three at least will hit between now and the end of Q2 of next year. But anytime in there trying to predict, you know, when a contract is signed is too difficult. We can't predict at this point whether we will have one of those that hits this quarter of this fiscal year or the first half of next year. Too difficult to predict. But the pipeline itself looks good. We have some chunky contracts in there and also a slathering of smaller contracts in the million-dollar range. So, we're pleased with their activity.

Craig Irwin:

Excellent. Well congratulations on the strong results guys. The 88%-win rate is really impressive. You know, 50% on the total opportunity is still just an absolutely fantastic result so congratulations.

Tom Brisbin: But Craig, you do know that's based on what we know at this point.

Craig Irwin: Yes.

Tom Brisbin: The budget, how they adjusted and what happens, you know.

Craig Irwin:

Yes. I know, I mean, that's why your language in the release is well written. We don't know how these projects ramp, we don't know final profitability, so I completely understand that as do most of the investors listening on this call. So, it's just…

Tom Brisbin:

You've been waiting a long time for some news and we were able to give you some news. And we're very pleased with the outcome. And like I said, we thank the IOUs for having their confidence in us and we're going to perform now so that we can continue to grow on this.

Craig Irwin: Again, congratulations. I'll hop back in the queue now.

Operator: Our next question will come from Moshi Katri with Wedbush. Please go ahead.

Moshi Katri:

Thanks. Congrats on strong results, strong bookings as well. A couple things, one, what needs to happen for you guys to execute? Assuming all these contracts get approved, how are you set up from an infrastructure perspective on the execution site? Do you need to add head count at executive project managers, et cetera? And then maybe you can provide some more color on other pending opportunities in terms of the pipeline. And then, in that context, can you remind us of there are any large renewals that we should expect heading into the next 12 to 24 months? Thanks a lot.

Mike Bieber: Okay. We'll break it down into three parts of your question (unintelligible).

Moshi Katri: Yes.

Mike Bieber:

In terms of ramp up, we fulfilled all of the project management and key positions, but we do need to add staff, quite a few staff in fact. And we're making that assessment right now. We are lucky that these procurements are staggered and some of the start dates aren't until the second half of next year, which is good for us. So, we are fortunate in the way they have become staggered and we'll be able to ramp up, you know, in a much easier manner than the tidal wave of work. So we're hiring right now. We filled the key positions. We don't know how many staff we'll have to add at this point, but we're guessing 50-ish, something like that all in California. And those will come on over the next, you know, three to six months. So, I think you asked about new business development activities. You wanted further color on that on the east coast.

Moshi Katri: Yes.

Mike Bieber: Tom you want to (unintelligible).

Tom Brisbin:

I mentioned a few of the states – Maryland, New Jersey. So what's happened is they have picked up on the east coast and we are submitting proposals, we're in interviews. It's kind of like the same thing we've been telling you about California. It's shifted to the – again, for us, California just about ended when the east coast picked but so we were able to take the team and the team on the other side of the country and respond to these opportunities. So, we're in active procurement mode. That means we submitted proposals or we're in interviews. And that's about all I can say about there, but I gave you some ideas in New Jersey, Maryland and some other northeast states. That's about…

Moshi Katri: … quantify these opportunities?

Tom Brisbin:

So, let's take an example that we're looking at right now, New Jersey. You have the opportunity to bid on – let's say there's 11 counties in New Jersey. You bid on one, you can bid on all 11. And it's a strategic decision you make as to what you bid on. So that directly relates to the revenue you'll generate. And if you get too greedy you could lose it all. Those are just the things that get into it. They want to spread the work, they want to give it to other contractors, they want to give it to minority business enterprises. I mean, the host of variable here are large. So, to tell you what we're…

Moshi Katri: Okay.

Tom Brisbin: …bidding on is to tell you what we're doing, and we can't do that.

Moshi Katri: Understood. And how about renew activity during the next 12 to 18 months.

Mike Bieber:

There's only one that I can think of which is about a $10 million contract with Tom Edison that will come up for renewal likely next year. But, that's the only one.

Moshi Katri: All right. Thanks a lot.

Operator: Our next question will come from Marc Riddick with Sidoti. Please go ahead.

Marc Riddick:

Hi, good evening. So, congratulations is certainly a significant amount of success with the wins. I was wondering if you could sort of touch a little bit – and thank you for the color with the pacing of what can be expected going into at least on the top line maybe to some degree going into next year. I was wondering from a hiring perspective and the idea that that is begun, are there particular areas of expertise that may require more senior folks versus some folks that can be trained? How should we think about maybe what that mix may be? And certainly you communicated that there's some amount of time that you have on your side but I was wondering if you could sort of go into that and then maybe how that procurement of that (unintelligible) skillset might play out in the quarters to come.

Tom Brisbin:

We're very fortunate that we've been working on these programs for an excess of 10 years here in California. And we've had the opportunity for many of our staff to take all sorts of positions, from sales to instillation to, you know, the M&D portion, the management portions, the county portions. So, we have a rather robust trained staff in California, just like we do on the east coast because we've been working there for 10 years. So, as these programs grow, what it really means is bringing in highly qualified entry-level people and training them by people who have been doing it for 10 years. So, it's just a matter of getting more people doing what we've been doing. Does that make sense to you? It's not a big leap to…

Marc Riddick: Yes. No, that made sense.

Tom Brisbin: Yes.

Marc Riddick: That made sense.

Marc Riddick: I was wondering if you could talk – I'm sorry, go ahead.

Tom Brisbin:

I was just going to say, you know, as a part of the proposal activity to have to show you have your key people in place and everybody to go on day one. That's just a requirement. And, again, we're fortunate that we've been working for these IOUs for so long. And I think it's a competitive advantage. To you it might look like risk. To us it looks like a competitive advantage and we're ready to go.

Marc Riddick:

Okay. Certainly, good to hear those. Wonder if you could touch a little bit on what the – if you could share a little bit more around the thought process on the real estate footprint going forward. You certainly touched on this a little bit in prior calls and commentary and so certainly appreciate the level of specifics which were given on this call today. Especially given in light of the (unintelligible). So I was wondering if you could talk a little bit about that thought process and maybe the things that led you to get there, especially as we're starting to see that little by little across the corporate world and rethinking their long term footprint.

Stacy McLaughlin:

Hi Marc. Yes, we've been looking at this and if you look at our G&A, our largest costs are salaries, our people and our facilities. So, it's one area that we can definitely make an impact on when it comes to cutting costs. And over these past seven or so months we have determined that we have a lot of space, but we can get a lot done without using all the space that we have. So it's something that we want to add to our goals moving forward to look at all of our leases as they come due and determine if they are spaces that are people really going into that office space and working or are they mostly remote and seeing where we can gain more efficiencies, being that it's one of our larger income statement items that's just overhead.

Marc Riddick: Okay, great. Thank you for the color there.

Operator:

And with no further questions I'd like to turn it back to Tom Brisbin for any additional or closing remarks.

Tom Brisbin:

Want to just thank everyone for joining us today and have a good day. Maybe when we get home, we might know who the president is. But maybe we'll know next week. So, thanks a lot for being a shareholder in Willdan.

END