WILLDAN GROUP, INC.
Q1 FY2021 Earnings Call
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CALL PARTICIPANTS

EXECUTIVES – WILLDAN GROUP
Al Kaschalk – VP Investor Relations
Tom Brisbin – CEO & Chairman
Kim Early - CFO
Mike Bieber - President

ANALYSTS / INVESTORS
Craig Irwin – ROTH Capital Partners
Moshi Katri – Wedbush Securities
Marc Riddick – Sidoti & Company

PRESENTATION

Operator
Good day, ladies and gentlemen, and welcome to the Willdan Group First Quarter Fiscal Year 2021 Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Al Kaschalk. Please go ahead.

Al Kaschalk, VP Investor Relations
Thank you, (Keith). Good afternoon, everyone, and welcome to Willdan Group's First Quarter 2021 Earnings Call. Joining our call today are Tom Brisbin, Chairman of the Board and Chief Executive Officer; Kim Early, Chief Financial Officer; and Mike Bieber, President.

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 Web site, willdan.com. 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 January 1, 2021.

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, we'll then 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.

After Tom's prepared remarks, Kim will provide a financial review. We'll then take your questions. Tom, over to you.

Tom Brisbin, Chief Executive Officer

Thanks, Al, and good afternoon, everyone. During our call this afternoon, we will highlight our Q1 results and give an update on the current operating environment.

Before we begin, I'd like to thank Stacy McLaughlin for her 10 years of service at Willdan, including the last five years as our Chief Financial Officer. We wish Stacy the best with her future career.

We'd also like to welcome Kim Early as Willdan's new Chief Financial Officer. Kim has been working closely with the executive management team at Willdan since 2015. Kim has been implementing Willdan's financial planning, forecasting, operations review and reporting processes. Kim previously served as Chief Financial Officer of various Willdan subsidiaries. We are excited to have Kim as our Chief Financial Officer.

During this call one year ago, we were all addressing a global pandemic. I noted that extraordinary times create the opportunity for change. We have had many changes to the way we work and live. We've learned to be more agile and respond to changing market conditions. For example, we can live with less real estate costs. We have become better cash flow managers. Communications have improved due to virtual meeting, no planes, no trains, no automobiles, thus reducing travel costs. Facing a threat together made us stronger. We took action on changes because of necessity that will benefit Willdan long term. And during this pandemic, we won more work than ever.

We certainly demonstrated this in the first quarter, delivering strong operational improvement by leveraging our recent cost reductions, unique software technologies and continued cost containment.

Some new news since March, when we last talked to you. During the first quarter, Integral Analytics signed another software license and continues to have a robust pipeline of software opportunities. Willdan's policy experts, E3 in our engineering groups just finished a decarbonization plan for New York City. We work closely with the New York City budget office, provided a pathway for all of New York City buildings to comply with Local Law 97. Local Law 97 is a very aggressive decarbonization plan all cities will follow.

Electrification of New York City buildings, nearly 4,000 of them, which include hospitals, schools, court houses, museums, et cetera, they all must need very aggressive goals over the next 15 years. E3 just finished another plant for the city of Philadelphia to address the city's gas systems. They are just beginning a study with the State of Massachusetts on their natural gas systems. This is all evidence that decarbonization is moving and Willdan is working on these very important assignments.

COVID restrictions impacted the first quarter, but temporary suspensions are being lifted and reopenings are expected to continue into the early part of the third quarter.

In late March, our Duke Direct Install Program had fully resumed. And the Los Angeles Unified School District program restarted at the end of April. The small business program with Los Angeles Department of Water and Power remains delayed. We are optimistic that the small business program in Los Angeles County resumes by June 2021, that all our programs will be fully operational.

In terms of the California energy efficiency contracts, awarded to Willdan, the Public Utility Commission recently approved the $100 million PG&E statewide new construction program. We have also been awarded a $12 million Southern California gas contract. We expect the California Public Utility Commission to provide their ruling on the four remaining contracts announced by the California IOUs over the next few months. California IOU programs are expected to ramp in the second half of 2021.

As a reminder, the energy efficiency contracts awarded in December of 2020 only represents about 30% of the outsourcing that the California IOUs have done. They must outsource 100% of their energy efficiency services by 2025, as mandated by the CPUC. We have also been awarded new utility work in the Northeast pending final approvals.

Customers are actively conducting procurements in 2021 as climate change goals and pathway for decarbonization continues. By the midterm of this year, we are positioned to produce double-digit organic growth.

On behalf of our Board of Directors, management and shareholders, we would like to thank our employees again and customers for their continued 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 a high priority and your continued resiliency and dedication are greatly appreciated.

I will now turn the call over to Kim to discuss our financial results in more detail. Kim?

Kim Early, Chief Financial Officer

Thanks, Tom, and good afternoon, everyone. I'm glad to have the opportunity to speak to all of you today. I'm honored to be named as the new CFO of Willdan and to be given the opportunity to continue to work together with this management team.

Since joining Willdan more than five years ago, I've been excited by the growth opportunities facing the Company as well as the energy and dedication of our people in the pursuit of a sustainable future. I'm looking forward to meeting many of you in the future and talking more about Willdan.

Now on to our financials. Our first quarter results were better than we had expected but reflect some of the headwinds we continue to experience from the COVID pandemic. Gross revenues were down 25% compared to a year ago, but net revenues, net of subcontractors, materials and other direct costs were off only 3%. Subcontractor and other direct costs declined from 53% of gross revenues a year ago to 39% in 2021, due to the reduced percentage of revenue derived from our direct install and construction management activities, while software revenue increased. SG&A costs were $2.6 million or 7% lower in Q1 2021 compared to a year ago.

Our efforts at cost containment, the additional software licensing and margin improvement in our direct install activities led to the first quarter loss from operations being cut in half from $8.3 million a year ago to $4.2 million in Q1 of 2021. Adjusted EBITDA more than tripled from $1.3 million in Q1 of 2020 to $4.7 million in 2021. Our adjusted earnings per share improved from a loss of $0.13 per share a year ago to a positive $0.22 per share in 2021. We're pleased to report the improvement in operating results despite the challenges we encountered.

As Tom mentioned, our first quarter results were impacted by the temporary suspension of our direct install programs due to COVID related factors. The impact of those program suspensions accounts for the lion's share of the reduced revenues in comparison to the prior year, along with the fact that Q1 of 2021 was the traditional 13 weeks compared to 14 weeks in 2020. As the pandemic continues, we will continue to focus on margin improvement and cost containment.

From a balance sheet and cash flow perspective, results have also been positive. Our quarter end cash balance was $25 million compared to $12 million a year ago. And our $50 million line of credit remains untouched. Our net debt, which refers to total funded debt less the cash on hand has been reduced by $30 million over the past four quarters. Cash flow from operations was $5.6 million in Q1 of 2021 compared to $16.5 million in 2020, which benefited from a much sharper contraction in working capital requirements than in the current year due to the across the board suspensions a year ago.

The current quarter cash flows were impacted by an increase in our DSO from 82 days at year-end to 94 days at the end of March. This was primarily due to some temporary billing delays and a few of our projects being financed through on bill financing from a utility. Those projects were completed and have now been paid and our billing processes are back to normal, which will aid in returning the DSO measure to historic levels.

We're pleased to report that we've been able to amend our bank agreements to extend our covenant relief period through Q1 of 2022, adjust our leverage in minimum EBITDA covenants and effective in the third quarter, adjust the LIBOR floor rate down from 0.75% to 0%. This amendment, thus, facilitates our planned ramp-up in working capital requirements related to the expected restart of the LADWP program and the ramp-up of the new California IOU contracts in the second half of this year. It also reduces our interest expense in the second half of the year. We expect interest expense for the full year to be comparable to 2020 depending on the steepness of our second half revenue ramp.

Overall, we're satisfied our Q1 results reflect continued progress in improving our operating results and our balance sheet and positions us well for growth in the second half of the year.

I'll now return to the operator for questions.

QUESTION AND ANSWER

Operator

Ladies and gentlemen, if you would like to ask a question please signal by pressing star one on your telephone keypad. If using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Star one for questions. We'll pause a moment to give everyone an opportunity to signal for questions.

We'll take our first question from Craig Irwin with ROTH Capital Partners.

Craig Irwin, ROTH Capital Partners

There were multiple good news items in there tonight. So that's really nice to see. I don't know what I want to start with. I guess, Integral Analytics, right, were now writing contracts again. Has something changed for customers to start actually executing these contracts?

I know they are probably facing some challenges for their longer-term forecasting and some of the pinch points in the grid, all things that Integral Analytics helps them directly address. But maybe was there something that happened at the commission or something that happened externally that helped move this forward that might move the sort of broader opportunity mix that you guys have been chasing to more rapidly convert?

Tom Brisbin, Willdan Group

Craig, this contract and the ones in our pipeline are a result of long-term trends towards a higher degree of DERs in the mix for these utilities. As the utilities adopt DERs and their grids become more complicated, like in the case of PG&E, where we've got a lot of solar and wind, this is the logical solution for them. So I wouldn't – this has been a slow change. This has taken several years and where you've got high DER concentrations, that is a perfect environment for this type of solution.

Craig Irwin, ROTH Capital Partners
Understood. Understood. So perfect environment, hopefully, translates to additional awards before too long. So I guess, we all want that to happen.

Second question I wanted to ask is, EBITDA margins were surprisingly strong. We all know that you're carrying a little bit of expense for LADWP and I guess that's more of the good news we can talk about. But can you maybe talk us through the EBITDA margin strength in the quarter? What's going well for you that's allowing you to outperform there?

Tom Brisbin, Willdan Group
Two things. One, it was pretty good performance on the base business, pretty good performance. A little better than we expected with the existing direct install programs that are running, that being on both the East Coast and the West Coast. And in addition to that, on top of good performance, I'd say, across the board, we did have the adder of software license occurring in March. That was the PG&E announcement that you saw in the press release. So those two things contributed to a pretty good quarter.

Craig Irwin, ROTH Capital Partners
Excellent. And then if we could talk a little bit more about LADWP. How do you see people probably coming back to work for LADWP? Is this something you've been in discussions with the utility around how you would do this? What's sort of the range of scenarios we're looking at here? And can you help us frame out the impact in the second half of the year?

Tom Brisbin, Willdan Group
What we know is the unions who do a lot – who do the installs and the audit in LADWP territory are chomping at the bid to start. So coming back to work for them, they are just sitting there like caged animals. They want to go.

Our people, in a similar situation, our audit teams, a lot of them who have been furloughed are starting down in San Diego on our San Diego Gas & Electric work so that they can get up and running that new contract. And then they're going to – they're in place, ready to go, and they're ready for the June switchover to come back to LA. So we're fortunate that way. Work staffs all in place. And you're right, we are carrying a little load for that. But I don't see any bad things that could happen and prevent us from going full out. Do you, Mike?

Mike Bieber, Willdan Group
Not at this point, the client has asked us for a detailed health and safety plan to get restarted. So good sign.

Craig Irwin, ROTH Capital Partners
Excellent. So can you remind us how big they were for you in 2019? And is it possible for us to reach sort of a run rate consistent with that by the back end of the year? Or maybe is there growth in there? Given the enthusiasm for energy efficiency in this economy?

Tom Brisbin, Willdan Group
Yes, Craig. 2019 is really not a valid comparison because the program has grown since then. So there's two parts of the contract. The LAUSD portion of the contract is $15 million per year. That restarted in April, and we do expect to extend all of that this year.

The second part of the contract is the LADWP direct install program. We're expecting that to start in June. It's $66 million a year. And the wildcard is how much do we do this year. Conservatively, we could say, over $20 million. Can we do a lot more than that? We don't know yet. That is still a wildcard that we're in discussions with the clients about. So budget, though is not a limitation. So we're in discussions right now on that. We don't have the answer.

Craig Irwin, ROTH Capital Partners
So I mean, is it fair to assume that really, safety is the gating factor and that's what 20-plus revenue is really linked to for second half? I mean, so the potential flush there is if the vaccinations everybody is getting now are at least somewhat effective and somewhat enhance the safety that that's what will allow you to flush an activity into the back end of the year?

Tom Brisbin, Willdan Group
You've got it. That's exactly right.

Operator
We'll take our next question from Moshe Katri with Wedbush.

Moshe Katri, Wedbush Securities
Nice, nice results, good results, guys. Just – I noticed that you didn't provide guidance for the year. And I get it, we still don't have full visibility, but I'm assuming some of that visibility is back and then are there any specific call-outs for you that – for you to make? Can you make any specific call-outs on the next few quarters? June, maybe the second half for us to kind of use to be able to kind of build our model, anything on some of the metrics that we track will be helpful? I'll start with that.

Tom Brisbin, Willdan Group
Yes, Moshe. First, with respect to guidance, we would look to resume guidance when we have visibility on a start date for LADWP. We don't actually have a start date yet. We're just estimating June 1. And we get some visibility on when the commission would approve the three large SCE contracts. That's material because it's roughly 2/3 the total volume of work with this California IOU work. So when we get clarity on those two, we'll consider reissuing guidance.

Your second point was and those are the variables we don't know. How should we cue you in on the second half rather than take that on a public call, I think it's probably better if we work with you on your model after the call. If that's okay, Moshe.

Moshe Katri, Wedbush Securities
Sure. Sure, of course. And then as a follow-up, maybe you can talk a bit about how Willdan is getting prepared structurally and in terms of the infrastructure and delivery to be able to kind of process all this work that's coming through. If you can talk about recruiting, project managers, all the things that you need to have in place to be able to kind of process all this work that's coming through. And obviously, on time, on budget, and that obviously will be critical in order for you to continue to get incremental work on some of those vehicles?

Tom Brisbin, Willdan Group
Well, we have – like I've said on previous calls, we're fortunate that we're a California company. We have many, many of the employees in place. They have historically worked on these utility programs. So we do have past experience, past people. We're also – although one could look at it is we like it all, once, it's not true.

PG&E's public program started first, then the San Diego Gas & Electric small business went second. So we are really ramping up, even though the teams in LA are waiting for SCE, we're shifting them to other programs to work as we wait for SCE to move. So they're getting experience in helping us with the start-ups. And finding people as of right now has not been an issue, even though you see on the news a lot that people are hard to find.

We are fortunate that a lot of people want to work in sustainability. They want to work on energy efficiency. They come here to learn and then help us with our programs and help the utilities. They believe that. So – and we have a lot of really good people. It's – right now, we're around 50 people. We're staffed up to proceed. We take a final number, maybe around 90. So that ramp up from 50 to 90 will probably be over a six-month period, maybe a little longer.

Moshe Katri, Wedbush Securities
All right. That's helpful. And then the – my final question is going to be about some of the other emerging opportunities out of California, maybe you can talk about that and maybe the timing for proposal activity and awards, et cetera?

Tom Brisbin, Willdan Group
So we did a press release (on SoCalGas)?

Mike Bieber, Willdan Group
No, it was in our earnings release.

Tom Brisbin, Willdan Group
It was in the earnings release. So we did get an additional contract beyond what we thought we would. So now all four IOUs, we have a contract with. And the last one was (SoCalGas) to do energy efficiency. And we do have proposals in many, many places of California. There will be a transition from pure energy efficiency to doing more EE plus DER, plus storage, plus renewables. And we've already submitted proposals on how that affects the grid. And as Mike said, Integral Analytics work will be more and more important on how these DERs affect the grid. So we see utilities making that shift, and we're submitting proposals on it. If you go across the country, the same things taking place. We still see a lot of activity in the Northeast and the Midwest. So we are slammed with opportunity, and there's no shortage of emotion.

Operator
We'll take our next question from Marc Riddick with Sidoti.

Marc Riddick, Sidoti
I'm wondering if you could bring – was wondering if you could bring us up to date – we talked a little bit about this, I believe, at the end of the last call, but I was wondering if you could bring us up-to-date on the acquisition pipeline and sort of your – obviously, there's been quite a lot you've been working on, but if I recall correctly, were considering or just beginning to sort of get our toe back into to looking at some opportunities there. I was wondering if you could sort of discuss maybe what that – if so, how that process is looking like and how you're feeling about prioritization and valuations that are out there.

Tom Brisbin, Willdan Group
Tom Brisbin: So Kim and I are actually the people who typically look at those. And the market is still very fractured. There's a lot of opportunities. Most of our deals are curated internally. There are subcontractors or partners, people we work with. We've got a good pipeline of those. And in addition to that, those that choose to go to an investment banker, there's no shortage of those either. There's quite a few. We see them every week crossing our desk. So there are deals we would like to do.

Now we have amended our credit facility, which gives us a little more flexibility along that. I would not look for an acquisition certainly before – in the next quarter or so. But over the next three, four, five quarters, we'll get back in that game, and we've got some good companies that we would like to add to our capabilities with.

Marc Riddick, Sidoti
Okay. That's certainly encouraging. And then I wanted to shift gears and see if you can sort of bring us up to speed on how you're feeling about maybe some of the initial things that you're seeing or some of the latest things that you're hearing about the funding environment for your key customer and prospect groups out there, sort of whether it's just improving sentiment or actual progress on funding availability that could lead to new business wins for the Company?

Tom Brisbin, Willdan Group
We're going to give this question to Kim Early. Kim, this is your first question.

Kim Early, Willdan Group
Yes. Well, that's great. Thanks for passing that. Yes. Actually, I think the view is pretty optimistic. I think the municipal environment has been surprisingly strong for us. And we're continuing to see pretty strong funding within that piece.

As you know, we do a fair amount with school programs, hospital programs, I think the funding from the infrastructure bills that the Congress is contemplating and the aid that they're giving to state and local governments, that is going to be positive for us.

Also the idea of funding additional improvements to the grid and the transmission lines, all positive signs for us. So I think when we look at funding mechanisms, both in terms of cash being supplied there from the government, surprisingly strong to us. Also financing sources, lots of interesting financing sources, looking to finance energy efficiency improvements and as well as generation facilities. So we don't think funding is going to be an issue when we're looking forward.

Tom Brisbin, Willdan Group
Yes. Marc, I can do with that question.

Marc Riddick, Sidoti
It was fantastic. It was an outstanding job, and I greatly appreciate and understand as it is his first one.

Tom Brisbin, Willdan Group
Should we keep him?

Marc Riddick, Sidoti
So far, so good. I think you're in pretty good shape. One last one for me, if I could. I was sort of thinking about the time frame. Well, I guess maybe there have been prior conversations and discussions around kind of how you're imagining your own real estate needs in a post pandemic environment. I was wondering if you had any updated thoughts on learnings and sort of kind of where your thinking is currently on that?

Tom Brisbin, Willdan Group
We just got a number we threw on the Board. That – and it could be more, could be less. But right now, we've got a number on the Board that we think we need 50% less real estate. The concept of hoteling for us being a service industry. People are – numbers being thrown out, how many days a week do they want to come in and work, we're somewhere between two and three. So that would pretty much put you at about 50% if we hotel it. So those are the things we're putting on the Board. That's the way it's looking right now.

Wait, you may want to know. So most of our leases are two to three years. We have some at four or five, but on average, it's about a three-year duration. So we should at – reduction in cost over a two to three-year period. That might help.

Operator:
And ladies and gentlemen, as a reminder, star one for questions or comments please. Star one. We'll pause a moment to assemble the queue. We'll take our next question from Craig Irwin with ROTH Capital Partners.

Craig Irwin, ROTH Capital Partners
So the most important question is really upcoming solicitations, right? You guys did an impeccable job in what was put out to bid, looking backwards. And looking forward, there are publicly posted solicitation timelines identifying different pieces for different utilities that are up for bid. It looks like SCE has a fairly heavy bid schedule this year with contract negotiations in the second half.

PG&E looks mostly done, but San Diego Gas also gets very busy later on this year. And it looks like they have a large chunk of their business yet to award in late 2021 and '22. And then obviously, (SoCalGas) in – depending '21, '22, I guess this is probably going to slip into '22 given timelines. But what do you feel about the opportunity to bid on these upcoming programs, are they a natural fit for your capabilities? Do you have any sort of feeling of rough scope that you would like to bid for or you could possibly bid for both this calendar year and next year?

Tom Brisbin, Willdan Group
Craig, right now in California. If we give excellent performance and we deliver, we won't have to worry about bidding. Performance is everything at this point. So I think that question out next year or the next year, we'll wait on that, and we're totally focused on delivering the goals for the utilities as they have now awarded them to us. And then the utilities will make a decision.

If we've got an A+ performance, do we want to stick with an A+ performance or do we want to go somewhere else. So right now, it's based purely on performance. This California experience will transfer across the country because California has done something that no other state has done yet.

Craig Irwin, ROTH Capital Partners
That makes complete sense. But can you maybe frame out for us? Are we looking at a similar dollar value as to what you've captured now as what might be available over the next couple of years?

Tom Brisbin, Willdan Group
Yes. But I would not say, if you look at the dollar value, I would say that it's not going to come from California. There might be some increase for different types of programs. But if you wanted to repeat what we did in California, it would come from several states.

Operator
We'll take our next question from Moshe Katri with Wedbush.

Moshe Katri, Wedbush Securities
Just a follow-up, can we get an update on your pipeline for Integral Analytics? Is there a way to kind of quantify the TCV and then what sort of opportunities are there out there at this point are you bidding for?

Mike Bieber, Willdan Group
Here's how I describe it. We've got a number of contracts, but here's how I grade them. If we signed one more contract this year, a new additional contract, a new additional utility, that's a B performance. That's pretty good performance. If we sign two more this year, that's A performance. And if we signed any more than that, gosh, we're getting overloaded in work. So good pipeline. That's how I would describe it.

Moshe Katri, Wedbush Securities
Okay. And is there any – are you indicating – I think you've kind of alluded on the call that the sales cycles are contracting or the decisions are kind of coming through much quicker than what you've seen in the past. Maybe you can talk a bit about that?

Mike Bieber, Willdan Group
I would say that the sales cycles are the same. Which is frustratingly long. They are taking one to two years to decide. But we built the pipeline that we're now realizing a year or two ago. So those – that work that we did over the last 12 months is paying off now. That's the contracts that we're working on and negotiating with customers right now. So.

Operator
As a reminder, star one for questions. We'll pause a moment to assemble the queue. It appears we have no further questions in the queue. I would like to turn the conference back to your speakers for any additional or closing remarks.

Tom Brisbin, Willdan Group
Just thanks, everyone, and thanks for your continued interest in Willdan. So we'll see you in about 90 days. Thanks again.

Operator
Ladies and gentlemen, this does conclude today's conference. We appreciate your participation. You may now disconnect.