WILLDAN GROUP, INC.

Third Quarter Fiscal Year 2021 Conference Call

November 4, 2021

(edited)

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
Chip Moore – EFHutton
Marc Riddick – Sidoti & Company
Moshi Katri – Wedbush Securities

PRESENTATION

Operator

Good day, and welcome to the Willdan Group Third Quarter Fiscal Year 2021 Conference Call. Today's conference is being recorded. And at this time, I would like to turn the conference over to Al Kaschalk, VP, Investor Relations. Please go ahead, sir.

Al Kaschalk, VP Investor Relations

Thank you, (Jenny). Good afternoon, everyone, and welcome to Willdan Group's Third 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 stock information 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 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.

Tom, I'll turn the call over to you.

Tom Brisbin, Chief Executive Officer

Thanks, Al, and good afternoon, everyone. During our call this afternoon, I will provide an update on the current operating environment, and Kim will review our Q3 financial results. Our third quarter results were ahead of expectation. LADWP start date was June 21, then we had three months of ramp up in our results. We also received a notice to proceed on all our California IOU that the investor-owned utility contracts, with the largest being Southern California Edison on September 15.

We're in the process of ramping or starting all of our California utility contract. We had no contracts that have any COVID-19 restriction other than state and local health and safety requirements. All are fully authorized to proceed, and funding is in place. We expect meaningful revenue from the California IOU contracts in Q1 of next year as we continue to ramp up through the fourth quarter.

Our Engineering and Consulting segment continues to deliver steady performance and growing demand. We have grown organically at 5% in 2021 in part due to the collaboration efforts with our Energy segment. Our software business at Integral Analytics sold two new small licenses in Q3. Software revenue is still small overall at about $10 million in 2021, but it has become a meaningful profit contributor to Willdan.

Additionally, in Q3, we successfully launched our internally developed software platform, Viewpoint. Viewpoint contains the best of Willdan's proprietary technology on a single platform to manage utility programs. Approximately 10% of our workforce is now software program, and this will further add to Willdan's technology differentiation in the market.

We have a big challenge before delivering these massive California IOU programs. We know we can do it. We are confident based on our nationwide experience, lessons learned over the past 15 years, data management capabilities, exceptional people, experienced incumbent teaming partners and their desire to be the best firm in the nation. We expect less than $10 million in the fourth quarter as we get started with the new California IOU program.

Turning to the LADWP program. The team delivered strong financial results. I'm happy to report that as of last week, one month into the fourth quarter, operations at LADWP have returned to our pre pandemic run rate. As we discussed last quarter, LADWP did not spend their budget for energy efficiency service for approximately 15 months. We continue to advance discussions with our clients on how to invest in these unused program dollars over the next -- over the near term, which would be additional to our base program. Thank you to all the staff who have been instrumental in the restart and a team that has developed our Viewpoint online platform to expedite work to improve efficiency as well as lower our overall costs related to this program.

We expect the LADWP team to meet the challenges of our rapidly growing program. We are encouraged by our growing risk of opportunity. The diversity of our capabilities and a cross-selling collaboration is provided a contract capacity for double-digit organic growth over the next three years.

Expanding markets such as electrification as facilities attempt to reduce fossil fuels or grid modernization as utilities tackle the problems of distributed energy resources and resiliency as the loan growth because of the transportation fleet going to EV. As we have said, nuclear and fossil fuels are going away. The electric load is widely expected to reverse course and increase. This disruption is creating opportunities for Willdan. Today, our pipeline and backlog are at record highs.

I want to share some of the new business wins. We expect to issue a press release for the majority of these awards after the client approves the details, and we can then share with the marketplace. But following are examples a $90 million three-year design-build contract to reduce infrastructure-related greenhouse gases in New York City. This new first of its kind program introduces innovative electrification (mediators) to specifically lower the carbon footprint and improve infrastructure and public housing facilities. Willdan's technical approach was selected competitively above all others and has application across the United States.

Another one here is a new five-year $24 million energy efficiency program for a large mid-Atlantic investor-owned utility. We've been a major competitor to grow into this new geographic territory. We have also been awarded additional work with multifamily housing in New York City. This work, again, is challenging, but it is substantial and addresses equity as we move forward. We are working on a decarbonization plan for New York City building to meet their near and long-term climate goals. As a result, we'll be working on a long-term energy plan for the entire city. We have been working on a climate plan for New York State.

The point we are making is the leaders in climate action have been California, New York and Massachusetts are entrusting Willdan with their transition to a clean energy economy. In summary, we are emerging a stronger post pandemic company. We did not lose any capabilities for contract value. We actually gained substantial market share. Now we must deliver and get back to the growth rates that our shareholders expect. Thank you to our employees and our shareholders for their continued support.

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

Kim Early, Chief Financial Officer

Thanks, Tom, and good afternoon, everyone.

Overall, we had a very good Q3, with revenue, earnings and cash flows exceeding expectations as we focused on execution. Gross revenue for the third quarter was $98.3 million, a decline of $6.2 million or 5.9% from the same quarter a year ago, while net revenue net of subcontractors, materials and other direct cost, was $54.5 million for the quarter, an increase of $3.5 million or 6.8% compared to Q3 in 2020. The divergent directions for gross and net revenue are a result of a shift in the mix of revenue as the increased revenue from LADWP and other utilities was offset by lower construction management revenue.

The construction management activities generate significantly smaller net revenue as a percentage of gross. And thus, the reduction in gross revenue is significantly greater than the reduction in net revenues. The decline in construction management revenue is a result of project completions earlier in the year, not yet being fully offset by the start-up of new projects despite the strong backlog of new contract.

G&A costs were $3.6 million or 11% higher in Q3 2021 compared to the year ago quarter, reflecting increased staffing, professional services and travel charges as we work to start-up the new California IOU contracts and other organic expansion opportunities. The higher SG&A costs were partially offset by the higher margins in net revenue, resulting in adjusted EBITDA for the quarter of $10.1 million for the quarter compared to $11.0 million in Q3 of 2020. The adjusted EBITDA margin for the quarter was 18.6% of net revenue.

Our adjusted earnings per share were $0.53 per share for Q3 of 2021 compared to $0.68 per share in 2020. Nearly all the difference in adjusted earnings per share is accounted for by tax deductions and credits realized in 2020 that were not repeated in the third quarter of 2021. For the nine months to date, gross revenue of $261.5 million was down 11.1% compared to a year ago, but net revenue increased by 4.1% to $149.7 million. The change in the mix of revenue sources accounts for the differing trajectories of gross and net revenue through the first nine months of the year.

The gross revenue reductions in our construction management activities translate to smaller reductions in our net revenue due to the higher subcontracting materials content, while the gross revenue increases from utility programs and advisory services have lower pass-through expenses and therefore, translate to a far higher increase in net revenue. The mix of revenue also accounts for the majority of the 640-basis point improvement in gross margin year-to-date when compared to the same period in 2020. The higher gross profit was partially offset by a 5.3% increase in G&A costs versus a year ago.

The higher G&A costs were due to wage and staffing reductions implemented in Q2 of 2020, which were later restored as well as stepped up activities related to the new California IOU programs and other organic expansion opportunities in 2021. Interest expense in 2021 was $900,000 lower than a year ago on reduced debt levels. As a result of an increase in various deductions and credits, our effective tax rate was a credit of 41.6% versus a credit of 23.8% in 2020. The net effect of those changes resulted in adjusted EBITDA of $18.1 million for the first nine months compared to $19.5 million a year ago, and adjusted earnings per share were $0.99 compared to $0.77 in 2020.

The changes in our balance sheet and cash flow reflect this changing mix of revenues, the impact of the restart of the LADWP program and the startup of the new California IOU program and continued debt reduction. Cash used in operations was $1.7 million for the nine-month period as the working capital expansion required by program start-up costs offset the cash generation from revenues. Scheduled principal payments on our term loans and earn-out payments resulting from successful acquisition performance, comprised the majority of $17 million used in financing activities. And $4.8 million in capital expenditures comprised the remaining cash usage.

As a result, our cash balance has been reduced from $28.4 million at year-end to $4.8 million at the end of the third quarter. Our $50 million line of credit and $20 million of available delayed draw term loans remains unused at quarter end. We do expect, however, the restart of the LADWP program and the commencement of the new SCE programs in Q4 will expand our working capital requirements and result in some usage of the line in Q4. We would expect to continue to use the line until cash flows from the expanding revenue begin to catch up in the second half of 2022.

Operator, we're now prepared to answer questions.

QUESTION AND ANSWER

Operator

Thank you. If you would like to ask a question, please signal by pressing star 1 on your telephone keypad. And if you’re using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. I'll pause for just a moment to allow everyone an opportunity to signal for questions.

And we will go first to Craig Irwin of ROTH Capital. Craig, your line is open. Please go ahead.

Craig Irwin, ROTH Capital Partners
Hi, I apologize, it was on mute. So, thank you for taking my questions and congratulations on another really solid results here. So, Tom, gosh, it was probably three or four years ago, there was a major budget flush in the fourth quarter. Your customers had underspent during the year and really wanted to keep up with their energy efficiency priorities. Now I know this environment we've been through in the last two years now is a strange one.

So, it's very difficult to predict. And capital budgets are not necessarily sort of what was marked at the front end. But can you maybe talk us through how a budget flush might work? And is this in the realm of possibility for the fourth quarter for Willdan?

Tom Brisbin, Willdan Group
Normally, that has happened. But given the fact we're coming out of COVID, I would temper those thoughts that we see kind of a steady state during the fourth quarter. So it's not so much with the bureaucracy of the contracts, COVID anymore. It's really the start-up and sell into a customer base that is coming out of COVID at a, I'd say, medium rate. So I would temper those thoughts this year. Does that help you, Craig?

Craig Irwin, ROTH Capital Partners
That absolutely does. That absolutely does. So other than execution, which everybody is kind of guessing their way in front of your quarters, the second most common question from investors is the outlook for the IOU bid schedule for 2022 and the potential scope of work. Now I know you've been conservative about what you've said there, given that you still -- you haven't really started to burn the revenue that is the opportunity to capture already.

But can you maybe just sketch it out for us, give us an idea roughly how active you see your bid teams being? And maybe if you're not comfortable with a dollar value, maybe a proportionate measure that kind of indicates to us what's available versus what's already been contracted would be really helpful for people looking at the future.

Tom Brisbin, Willdan Group
What's available has grown during the pandemic because it's been delayed in the schedules. The endpoints of the schedules are still the same. So, they're trying to pack more of what's available into less time. That -- so our budgets have actually grown. So, the question I think, is how much can we pack into the three or four years that we have left on all this. In some cases, five years. But, Mike, do you want to add to that? I don't know if I got his whole question.

Mike Bieber, Willdan Group
Well, all of the new projects have started, first of all. We'll start to ramp in Q4. You'll see a little bit of that, but the major impact is next year. And I would say that it's likely each of the next four quarters in 2022 will be progressively greater than the earlier quarter. So Q4 may be our largest exiting 2022 and that will continue to grow into 2023 very likely so. You know that the run rate just for the California IOU programs has to average $150 million of incremental revenue over the next four and a half years.

So to the extent we do, let's say, less than $100 million next year, that means we have to be up around $200 million in 2022 to hit all the milestones. Further than that, Craig, it's difficult to break down at this point, but we will break down for investors as we get back to guidance in March of 2022 with the announcement of our fourth quarter and provide a pretty detailed outlook of what we think it's going to look like at that point. But since we're just getting started right now, we're going to wait a couple of months to do that.

Craig Irwin, ROTH Capital Partners
Understood. So maybe can you just give us a couple comments on the specific opportunity for new projects, new contracts, not the contracts that you've already won?

Tom Brisbin, Willdan Group
So when we went through the script here, Craig, what we tried to demonstrate was what's going on in the other parts of the country. And we gave you a $90 million example for, let's just call it, housing, multifamily housing in New York City, where there's about -- this is just one unit, and they want to revamp how the buildings are heated, cooled. And the first award through the public housing facilities in New York City, Willdan has won, that was $90 million. So that's new. I also talked about a new energy contract that's been signed, but we can't announce yet in the mid-Atlantic are the $24 million.

But what is also exciting is what we're doing in New York City and the state and helping them how to decarbonize. So, we're not only helping them with call the path or the formula, but the rest of Willdan is also working in all the buildings to model them. We're also rendering the design and the upgrades. So that's -- we try to give you a little flavor of other states. But then if you go back to California, and like Mike said, we're going to peak out around '23 maybe, the end of '23, this is going to just keep ramping for three years. And as you said, the less we do now, the more we got to do later.

So then what comes is, as you know, better than I do, Craig. They've only outsourced about a third in California. So, we'll be back in California going after more if we do well on delivering for the next couple of years. So, there's huge opportunity growing in this area of, let's call it, I don't know, electrification, grid modernization, renewables, whatever term you want to put on it. I guess you just want me to repeat this all the time. This might be a softball question from you, but -- yes.

Craig Irwin, ROTH Capital Partners
Sort of but not really. You answered – yes, you gave me what I wanted. I know you're kind of shy about saying one third is done. There’re two thirds out there. But that's really what investors want to understand. So, thank you.

Just another couple of very quick questions, if I may. Labor is a hot subject for a lot of companies, investors are watching closely, particularly on the services side, right? You guys have navigated well to put up the results you gave us. Can you talk a little bit about the labor capacity and your confidence in having sufficient labor to execute on the revenue ramp?

Tom Brisbin, Willdan Group
We've been a very good attractor of talent during this period. And we have ramped up effectively. We've hired about 100 new people, new faces in California and even more across other parts of the company. Attracting talent has not been an issue to us, Craig, to my surprise, actually. People want to come to work at Willdan. We have a lot of work and a lot of job openings, and we're acquiring and hiring a lot of talent. That's piece one.

Piece two, it is coming at some escalation. People are quoting anywhere from 5% to 7% escalation on labor rates. We're seeing the same thing occurring. We are passing that along to our clients in escalation. And our contracts, for the most part, allow us to do that. So labor is coming at a higher cost. But it hasn't been a restriction on growth.

Craig Irwin, ROTH Capital Partners
That's really excellent. And then last one, if I may. Another company in sort of a in ecosystem, not such a direct competitor, just gone out there and got themselves basically $1 billion EPC contract, massive pivot in the business model for them to build these massive energy storage facilities where they really don't have a ton of experience. With liquidated damages, that they're late and all sorts of other terms, you guys aren't going to surprise us with any changes to the business model or fundamental shifts in what you're doing to try and chase revenue. I mean, the initiatives that you have that you've communicated, can we expect these to be the ones that drive the model and consume your time over the next number of years?

Mike Bieber, Willdan Group
No changes in business model. It's working.

Craig Irwin, ROTH Capital Partners
Perfect, love it. Thank you, guys. Hey, congratulations on the strong results.

Operator
And we'll go to our next question from Chip Moore of EF Hutton.

Chip Moore, EFHutton
Hey, good evening, everybody. Thanks for taking the questions. Nice to have a lot of good things to talk about.

Mike Bieber, Willdan Group
Yes, Chip.

Chip Moore, EFHutton
Wondered if we could start maybe on the software side. I think in the past -- last quarter, you had factored in some wins for IA in the plan. Just wondering how we should be thinking about Q4, any margin implications? And the bigger picture, Tom, you talked about this new unified platform. Can you expand on that and what that brings?

Tom Brisbin, Willdan Group
Go ahead, Mike. Because you can hit both IA and can hit the Viewpoint?

Mike Bieber, Willdan Group
Okay. So, in IA, IA did exactly what we thought they were going to do in Q3. Two new small software licenses. We do not expect further software licenses in Q4. That would just be upside. They've had a great year and been a great contributor to the bottom line and more to come in 2022. So, they did a great job. Viewpoint has launched on LADWP. It's been two years in development. We've taken all of the proprietary technologies across the company that have been acquired and invented at Willdan and put them in one platform to be able to manage these large utility programs with.

It's called Viewpoint internally. It has a customer-facing portal. It allows subcontractors to log on and see where they are on their programs also. And it integrates technologies that Integral Analytics has, building modeling from the (White) Group and many other software technologies into one platform. This has never been done before, and it's working great at LADWP. We're about a month into the launch, and it's gone just like we expected. So, we're going to roll it out across the company.

Chip Moore, EFHutton
Great. Good to hear. Maybe one more on the new $90 million contract in New York City, nice win. I assume that's the multifamily opportunity you referenced last quarter. Maybe you can talk about -- I think you sort of hit on it already, but potential for that to grow with federal stimulus or things like this. It seems relatively early days. So just curious on the pipeline for those type of wins.

Tom Brisbin, Willdan Group
No. So I'll separate them. One is a utility type contract for multifamily. And one is another state authority for buildings and building complexes in multifamily. So, they are separate. They are two wins. And I'm looking at a diagram here on the Board that Mike put up, and there is overlap, and we can see synergies between them that will really help. So, Mike, do you want to expand on any of that?

Mike Bieber, Willdan Group
Well, these customers have different objectives and many problems in common. We run both major programs, and there's an opportunity to combine what we're doing in those programs and better serve these customers. So, we're going to work on that tonight actually. There are two new great wins, and they will contribute substantially to revenue and profitability over the next three years.

Tom Brisbin, Willdan Group
And I think the market for it is just unlimited. I mean we could never keep up with it across the country on how to tackle these high-rise multifamily type housing projects than what we would call cities with infrastructure that is anywhere from 50 to 75 years old. I mean the heating and cooling and the individual units, I mean, it's endless.

Chip Moore, EFHutton
Chip Moore: Yes. No, I remember when you just open your window, right, to let the heat (out). And ...

Tom Brisbin, Willdan Group
Yes. You go through New York -- right, you go through New York because everybody has got their window opened up to regulate the heat.

Chip Moore, EFHutton
Chip Moore: That’s right.

Tom Brisbin, Willdan Group
Tom Brisbin: That's it.

Chip Moore, EFHutton
Well, great to hear. Congrats on the momentum. Good to see you. Look forward to watching it here, thanks.

Mike Bieber, Willdan Group
Thanks, Chip.

Operator
And we'll move to our next question from Marc Riddick of Sidoti.

Marc Riddick, Sidoti
Hi, good evening. I wanted to -- a lot of questions have already been answered. So, I just wanted to sort of circle to another area. And I was thinking about the potential, if you could share of our acquisition appetite going forward, if there were any some targets that might make some sense or some services that are attractive to you? And if that's anything that you've -- I know you've certainly had a lot on your plate already, but I'm wondering if you can (please) spending any time on that.

Mike Bieber, Willdan Group
It's likely, Marc, that we will wait until mid-next year to complete acquisitions, but we're already starting to work on our next batch. We're resuming the pipeline, and the pipeline looks really good. Some of the areas we're looking at right now include software and technology in the energy space. They include electrical engineering and planning in the space, some energy policy consulting that we'd like to add and some geographic presence in New England.

So those are just four areas that we're evaluating. There are a number -- this is a very fractured market. So, this will go on for some time. These are all private companies. We're directly negotiating with, directly talking with, and we often work with them for several years. That's how they come to us. So, the pipeline looks good. I don't expect anything to be announced until mid-next year, but we're talking.

Marc Riddick, Sidoti
Okay. That's actually very encouraging to hear. And then, I guess, a second part for me would be around the hits going into next year. And I appreciate you actually sharing that you're looking at the link back to being in position to resume guidance going. Once you get through the process early next year, I think that's very encouraging. I was sort of thinking about the landscape of -- I know you mentioned higher labor cost of that range. I was wondering if you also had an update on the folks that you were talking about hiring by the end of the year. I think you were shooting for about a 100 by the end of the year. Could you give a update as to where you are there or if that goal post, well, has moved at all?

Mike Bieber, Willdan Group
We've, to the most part, completed that hiring. We've done a good job of it. We have a lot of brand-new employees that have just joined Willdan. Places we're still hiring include upstate New York and the Midwest. But California generally has been filled out and done a great job.

Marc Riddick, Sidoti
That’s very encouraging. Thank you.

Operator
And as a reminder, it is star 1 if you have a question at this time. We'll go to Moshe Katri of Wedbush.

Moshe Katri, Wedbush Securities
Yes, thanks. Let me add my congratulations on the strong execution. I have a couple of follow-ups. And let's go back for a second to the California contracts. So hypothetically, when I'm looking at my numbers, I'm assuming contribution -- gross revenue contributions go from $20 million this year, maybe $75 million next year and then maybe somewhere in that $150 million in '23. Does that -- are these kind of reasonable expectations based on what you're seeing right now?

Mike Bieber - President
They are reasonable expectations. If we execute, we can beat them. So yes.

Moshe Katri, Wedbush Securities
Okay. Okay. Good. And then I believe we had a discussion on what happens to margins when some of these contracts mature. And I'm assuming, are we still expecting margins to be accretive down the road by a couple of 100 basis points? Does that make sense?

Tom Brisbin, Willdan Group
Over the next three years? Yes.

Moshe Katri, Wedbush Securities
Yes, okay. Yes.

Mike Bieber - President
As we ramp up, and we should start to see some of that even in the back half of next year. Yes.

Moshe Katri, Wedbush Securities
Okay. Okay. Good. And then going back to Integral Analytics, I'm not sure, did you disclose how much revenues we generated from the operation this quarter? And how much -- how accretive it was to earnings?

Tom Brisbin, Willdan Group
We did not. We generally don't break out individual software deals, Moshe. I can tell you there were two small deals signed in the quarter, and that's what we expected. We've signed what I'll call, three new agencies or IOUs up this year. And that adds to, I think, three we sold last year. In total, for the year, Integral Analytics will do about $10 million in revenue. And as you know, their cost basis is about $6 million. So, you can do the math on that. They had a great year and are forming a great pipeline coming into 2022.

Moshe Katri, Wedbush Securities
All right. Helpful. And then you're delivering some of that also an a -- in a SaaS model. And I believe that was specifically targeting maybe small municipalities. Maybe talk about your success there and how much traction have you had, especially delivering in a SaaS model versus the older kind of legacy model?

Mike Bieber - President
We're just starting that strategy, and we were able to carve out small pieces of these contracts. We're building that software as a solution or annuity revenue. It was $2 million last year. I don't know. We're going to exit this year with something less than $3 million. It's still a small number, Moshe. And it's really our -- we're building a pipeline of those opportunities to sell into 2022 because the sales process is normally longer than 12 months. So we started this earlier in the year, and we're seeing more and more of those opportunities.

We would like to target, and this is a new area of business for us. As you mentioned, the municipal utilities out there, the largest of which is LADWP. These utilities don't have profit motive. They're trying to lower their cost basis for their utility clients. And this software is absolutely vital and helps them lower that cost basis through better planning and better execution of capital expenditures. So that's the market we're targeting, and we're filling the pipeline with those.

Moshe Katri, Wedbush Securities
Helpful, thanks.

Operator
And it appears there are no further questions at this time. I will now turn the call over to Tom Brisbin for any additional or closing comments.

Tom Brisbin, Willdan Group
We'd just like to thank everyone for joining us today, and have a good week, good weekend, and take care.

Operator
And so this concludes today's call. Thank you for your participation. You may now disconnect.