Willdan Group, Inc.
First Quarter FY2023 Earnings Conference Call *(edited)*
May 4, 2023

<u>Presenters</u>
Al Kaschalk, VP, Investor Relations
Tom Brisbin, Chairman of the Board and CEO
Kim Early, Chief Financial Officer
Mike Bieber, President

<u>Q&A Participants</u>
Chip Moore -- EF Hutton
Marc Riddick -- Sidoti

Operator

Good day, ladies and gentlemen, and welcome to the Willdan Group First Quarter 2023 Financial Results Conference Call.

All lines have been placed on a listen-only mode, and the floor will be open for your questions and comments, following the presentation. If you should require assistance throughout the conference, please press “*”, “0” on your telephone keypad, to reach a live operator.

At this time, it is my pleasure to turn the floor over to your host, Al Kaschalk. Sir, the floor is yours.

Al Kaschalk, VP Investor Relations

Welcome to Willdan Group's First Quarter 2023 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 the market close, today. You may find the earnings release and the Willdan investor report that accompanies today's call in the press release and Stock Information section of our Investor Relations website found at ir.willdan.com. Management will review prepared remarks, and then we'll 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 is 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 on time in the company's SEC reports including, but not limited to, the annual report on Form 10-K filed for the year ended December 30, 2022.

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 provides 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.

I will now turn the call over to Tom Brisbin, Willdan's Chairman and CEO.

Thomas Brisbin, Chairman & CEO

Thanks, Al, and good afternoon, everyone. Two months ago, we communicated that we had overcome the significant headwinds that were impacting our business and began our trend back to a growth company.

Our first quarter performance continues that trend, enabling us to deliver our best first quarter ever. The continuing improvement in our financial performance and our strong backlog gives us confidence we can deliver the full year 2023 outlook.

Let me share with you some additional details. Cities are important customers for us, and we have a 50-year long relationship in California. Our city services model provides us a unique opportunity to bring our energy and infrastructure capabilities to the municipalities. We expect the strength and demand for our engineering and financial services for cities to continue.

We do not see a slowdown due to inflation or a potential recession in this area. We expect the Inflation Reduction Act and the Infrastructure Investment and Jobs Act to help cities fund important new projects, over the next several years. In addition, we see our cities struggling with the difficulty in hiring qualified engineers. This helps our outsourcing model.

Our software business enrolled two new contracts for our distribution planning software, during the quarter. The larger contract was for one of the nation's largest energy investor-owned utilities. We also signed a software contract with one of the largest municipal-owned electric service companies. There are approximately 170 investor-owned utilities and 3,000 municipals.

The software business pipeline looks good. And strategically, we see opportunities in both markets to support distribution grid planning and forecasting in both, the near and midterm.

This market is being driven by electric vehicles and electrification. The load is growing on the grid. Our software solution helps them plan and optimize the solution.

Our New York Energy business is executing on their backlog. Work with the Dormitory Authority of the state of New York, the New York City Housing Authority, New York Power Authority, positions this group for 50% organic growth in 2023. They are electrifying NYCHA housing as a way to decarbonize the grid and provide better living for their residents.

Our performance engineering group is entering their strongest two quarters as it starts work on five new California-based performance engineering contracts. These wins were based on collaboration with our cities' engineering group.

Our new professional service contract with San Diego Gas & Electric is performing well. This 1-year customer service program supports small businesses, statewide, that are recovering from COVID. The California IOU contracts are performing well and were a positive contributor in the quarter. We expect the performance and contribution to continue throughout the year.

E3 continues to grow at 20%, plus. They provide high-end energy consulting to the entire country, helping develop the framework for the clean energy transition. They have been and will continue to be Willdan's light into the future and where we move for the continued growth of Willdan.

Last month, we released our 2022 sustainability report. At the forefront of Willdan's sustainability efforts is our commitment to achieve carbon neutrality, by next year.

In closing, 2023 is off to a solid start. With a strong first quarter performance and the strength of our backlog, we are on track to deliver the full year 2023 outlook we provided two months ago.

I want to thank our employees, customers and stockholders for their support. I will now turn the call over to Kim, who will provide additional details on our financial results.

Kim Early, Chief Financial Officer

Thanks, Tom, and good afternoon, everyone. Much has been accomplished from a financial perspective over the past two quarters. The amendment to our SCE commercial contracts in Q4 and the completion of new software licenses in Q1, ongoing strength from our municipal services segment and the continued solid performance of the rest of our business units have enabled us to generate more than $22 million in cash flow from operations, over the past two quarters.

Our Q1 gross revenue was up 11.7% and net revenue was up 23%, over the same period a year ago. All of that growth was organic.

Gross profit was 32% higher as gross margin improved to 40.2% in 2023, driven by the same courses increasing our revenue.

G&A expenses were essentially flat versus the same period a year ago, as increased employee and tenant compensation on the strong earnings was offset by reduced stock compensation expense.

Interest expense increased $1.7 million to $2.5 million in Q1 of 2023, due to the changing interest rate environment.

Our income tax rate was a seasonally high 44.7% in the quarter, compared to a credit of 38.8% in the first quarter of 2022, mainly due to the timing of certain discrete tax adjustments.

So, for the quarter, net income was $932,000 or $0.07 per share versus a loss of $3.8 million or a loss of $0.30 per share from Q1 a year ago. Adjusted EBITDA in Q1 of this year was $9.9 million, compared to $2.3 million in 2022 and adjusted earnings per share was $0.32 this year versus $0.07 per share a year ago.

It's a significant improvement in operating performance, which has enabled us to reduce our leverage ratio to 3.0 and bring our credit facilities back into compliance with our original loan covenants, removing the borrowing limitations under our $50 million line of credit. The net result is a reduction in our annual interest rate spread by 2%, saving about $2 million on an annual basis.

Our balance sheet also reflects the improved earnings and higher cash flows. Our cash balance at the end of March 2023 was $17.9 million, up $9.1 million from the end of 2022. We are on track to deliver the full year outlook we provided in March and continue to delever our balance sheet.

Moreover, we're encouraged by several factors, including significant improvement in Willdan's financial health, strong backlog of new contracts and new projects and ongoing proposal activities. We look forward to providing an update to our 2023 outlook with our next call. Operator, we're now prepared to answer questions.

Operator

Thank you. If you have a question or would like to make a comment, please press “*”, “1” on your telephone keypad, at this time. And if you would like to--and we have our first question from Chip Moore of EF Hutton. Please go ahead.

Chip Moore, EFHutton

Good evening. Good evening, hey, thanks for taking the question. Congrats on the very strong quarter. I guess I wanted to start with Kim. Your last comment there on updating guidance next call, I guess, just given that strong Q1 beat and what seems like good momentum across most of the business, just curious how to think about the existing guide, sort of high end, certainly seems very achievable, if not beating it. But what, I guess, what are some of the risks to the guidance and visibility you need to update that?

Kim Early, Chief Financial Officer

Well, there's always the question of timing on the start-ups of some of the projects that we have, and we're not seeing a lot of downside risk from supply chain issues. But there are the start-up timing issues, I think, that are always involved in exactly what the mix of revenue in any individual quarter that has a little bit of impact on the risk profile that we have there.

But we remain confident in the way that we’ve kind of forecasted the year, laid it out at the beginning of the year. And so, our expectations are--while we're optimistic, we're--we'll know a lot more, by the time we get to the next call.

Chip Moore, EFHutton

Understood. Appreciate that. And if I could ask on the software win for IA--or software wins, I should say, in particular, maybe just give us a sense of the scale and scope there. I'm assuming that contributed to the margins in the quarter. And then particularly with the largest, one of the larger IOUs out there, is that across their territory? Is there opportunity to expand that contract? And is there any sort of recurring service component?

Michael Bieber, President

Yeah, Chip, this is Mike. This is the first contract where we do have a companion service license and additionally, the software license. So, we'll be providing significant services to this customer, over the next five years. We're looking to provide that on an ongoing basis. As usual, we don't break out individual software licenses, but it really puts us ahead of our plan for Q1. We started off the year great, and we'll look at guidance again at the end of Q2. But right now, we feel pretty good that we're ahead of plan.

Chip Moore, EFHutton

Got it. Okay. And maybe just one more for me. I'll let others hop on. On the momentum you're seeing on the city side -- on engineering and financial services, as well, net revenues up 15%. It sounds like you've seen an acceleration there. You announced that electrification deal in Merced County. Just maybe if you could expand on that opportunity. It sounds like you're incrementally, more bullish on the synergies there. I would love to hear what you're seeing.

Thomas Brisbin, Chairman & CEO

The five projects that I mentioned collaboration on, our engineering legacy business was instrumental in making the introductions to do the performance contract; you referred to it as electrification. So we are seeing that synergy really taking place. Was that your question, Chip?

Chip Moore, EFHutton
Yeah, and then also on sort of backlog and outlook there. Obviously, a lot of funding to come from IRA and elsewhere, but how those discussions are going and when that sort of spigot could kick in?

Thomas Brisbin, Chairman & CEO
I think I already said the second and third quarter on the performance contracting will be very strong, and they're doing work for cities in California, as well as across the country. So, we see them growing. And we're very optimistic about the year.

Chip Moore, EFHutton
Great. I appreciate the color and congrats, again. I'll hop back in queue. Thanks.

Operator
Our next question is from Marc Riddick of Sidoti.

Marc Riddick, Sidoti
Hi, good evening. So, I was wondering if there was anything that you were seeing as far as the timing of customer activity or any tangible delays or changing order patterns that either would be tied to just general economic conditions, but also maybe some of the banking headlines that we've seen, if there's anything that would be connected to what you're seeing, currently?

Thomas Brisbin, Chairman & CEO
Yes. I referred to it in my prepared remarks. We have not seen anything change, due to inflation or a lot of talk about a recession. If you want to get very specific, when we talk to city managers, see financial people, what they're doing this time, which we think is different than '07 and '08, is it's not such a big surprise.

We've been talking about a recession for so long that they are preparing for; they are not spending. They are buckling down. And as I commented in my prepared remarks, they are not hardened. So, we provide outsourcing people to cities in a big way. So, they are going to more of an outsourced model.

So, we haven't felt any effect yet. And if there is one, unless it's a massive one like '07 and '08, we think we're going to be okay and much better than what we saw in '07 and '08. And we're now for more a little more detail, I think, Mike, they're 25% of our net revenue, where in '07 and '08, it was 100% of our net revenue. And on the 75% that's in the, let's call it, energy space, back in '08, they saw no effect. So, we are hoping for a similar outcome. Does that help you at all?

Marc Riddick, Sidoti

That's helpful. And then I guess the other part of the thought is, I was thinking about sort of maybe some of the labor availability and in some areas of the of the economy that's begun to have a little greater availability for better or worse. I suppose--just wondering if you could talk a little bit about maybe where your staffing needs are and the availability of labor has changed much over the last few months.

Thomas Brisbin, Chairman & CEO

We're pointing at each other, right now. I'm trying to get Mike to answer.

Marc Riddick, Sidoti

I didn't mean to create a standoff, I suppose.

Michael Bieber, President

So, Marc, labor is still tight in the U.S. As we mentioned last quarter, we did most of our hiring coming into this year. So, we have hired most of the positions. The remaining positions, we'll hire over the course of this year, as we continue to grow. Those would particularly be in our front-end services, our energy consulting business with E3; performance engineering, particularly electrical engineers, we need that resource. We've done most of the hiring in the energy efficiency business, so far.

Marc Riddick, Sidoti

Okay, that's helpful. I appreciate it. Thank you.

Operator

Thank you. And ladies and gentlemen, once again, if you do have a question or comment, please press "*", "1" on your telephone keypad. If at any time your question has been answered, you can remove yourself from the queue by pressing "1". One moment, as we pull for question. And there are no new questions.

Thomas Brisbin, Chairman & CEO

Okay. Thank you very much to everyone listening on the call today, and we will see you in about 90 days. So thanks again for being patient, and it was a good quarter, and we expect a good year. Take care.

Operator

This concludes today's conference. We thank you for your participation. You may disconnect your lines at this time and have a great day.