Q1 2018 Ecology and Environment Inc Earnings Call
December 13, 2017

C: Gerry Gallagher; Ecology and Environment, Inc.; President, CEO
C: John Mye; Ecology and Environment, Inc.; CFO

P: Randall Mehl; Stewardship Capital Advisors; Analyst
P: David Cohen; Minerva Advisors; Analyst
P: Edward Kissel; Forager Capital Management; Analyst

Operator: Good afternoon and welcome to the Ecology and Environment Incorporated 1st Quarter 2018 Investor Conference Call. Today's webcast is being recorded. The slide deck can be accessed in the top right corner of the webcast screen or on the investor relations page of E&E's corporate website at ene.com. At the time, I'd like to turn the call over to Mr. Gerry Gallagher.

Gerry Gallagher: Thank you for joining us to discuss Ecology and Environment's financial results for the first quarter of our fiscal year 2018. I'm Gerry Gallagher, E&E's President and CEO. Joining me on this call is our Chief Financial Officer; John Mye. After finishing our prepared remarks, we'll be happy to open up the call and take your questions.

Let's go to slide number one. Please note that certain statements made in the course of today's conference call may include forward-looking statements within the meaning of the 'Private Securities Litigation Reform Act of 1995. Forward-looking statements involving certain risks and uncertainties and it's important to note that the company's actual future results could differ materially from such forward-looking statements. The company cautions investors not to place undue reliance on any forward-looking statements made during the course of this conference call. Ecology and Environment disclaims any obligation to update any forward-looking statements made today. With that, I'd like to turn the presentation over to John Mye, and he will discuss with you our quarterly results.

John Mye: My main objective this afternoon is to present the financial results for your company for the 1st quarter of 2018. On slide two you will see the revenue less subcontract costs of $21.3 million in the first quarter of fiscal year 2018. It was relatively unchanged from the comparable period of 2017. Net income for Q1 2018 was $533,000 or 12 cents per share as compared with the net income of $888,000 or 21 cents per share for the first quarter of 2017.

Revenue less subcontract cost is the key revenue metric for our business, because this represents the revenue that we generate strictly from our consulting services as compared with passthrough revenue that we collect and pay out to subcontractors. A breakdown of revenue less subcontract costs in net income and an explanation of those trends by geographic region is provided in the next slide.

Slide three provides comparative quarterly results for our U.S. and South American operations. We report our geographic regions as business segments in our public filings which allows you to see the contributions from these business units. First, I will address our U.S. operations.

We maintain an allowance in other accrued liabilities for potential settlements related to government contracts. Favorable resolution of long-standing contracts settlement liabilities allowed us to record $0.6 million of additional revenue during the first quarter of last year. We did not record any similar adjustments during the current quarter ended October 28, 2017.

Now, excluding these settlement adjustments, revenues from U.S. operations decreased 5% during the current quarter compared with the same quarter of last year. The decrease was primarily due to lower project activity resulting from three factors. First we have experienced the trend of longer periods being required by various prospective commercial and federal clients to make contract award decisions.

Second, we have also experienced longer periods being required by certain clients to fund projects, define project scopes, and to schedule project work. And, third, delivery of services under certain projects was temporarily disrupted by hurricanes on the Gulf Coast and in Southern Florida that occurred early in the current quarter. Although the disrupted projects returned to normal operations late in the quarter, delivery of services and related revenues has been delayed.

Now, I'll address our South American operations. During fiscal years 2016 and 2017, our South American operations were adversely affected by unstable economic conditions driven primarily by depressed energy development and mining sectors. We experienced some improvement in economic conditions during fiscal year 2017, particularly in energy development and infrastructure sectors in Brazil and in Peru.

As you can see, our South American operations experienced significant improvement, and revenue, and earnings when compared with the same quarter of last year. Moving on to slide four. Slide four shows operating cash activity for Q1 2018 and Q1 2017 as well as cash balances at the end of those quarterly periods.

During the first quarter of this year, our cash position began to improve, continuing the positive trend from the past three fiscal years. This accumulated cash balance is an important resource for funding potential acquisitions and other strategic investments to meet our growth objectives.

And now I'll turn it back over to Gerry to finish our presentation.

Gerry Gallagher: We're on slide five. Market drivers and challenges for our business continue to evolve. Leadership and funding of government environmental programs is shifting from the federal level to states and local governments. E&E has offices in States such as New York, California, Florida, and Texas with strong environmental requirements, and programs, and opportunities there are important for our business.

The federal regulatory rollback is in progress or in process and the effects on our business in both the public and private sector remain unclear at this time. We do expect ongoing federal and state cleanup of legacy pollution and funding of these efforts to continue and therefore expect the prospects for our projects to continue in this area are good. In the energy sector, we see investment in liquified natural gas export terminals, renewable energy development, and electric transmission infrastructure continuing.

We expect our work in these areas to continue, however, delay in funding of project startups and more spend gate decisions have caused us some frustration, including as we experienced in our first quarter. We're encouraged that some of the LNG export terminal licensing projects were involved with are now beginning to move forward. The recent increase in damaging hurricane activity is expected to lead to more resilience planning and restoration opportunities similar to what we saw after storms Sandy and Irene.

E&E has contract mechanisms in place at the federal and State levels that can be tapped for supporting recovery phase efforts and the company is pursuing opportunities for participating in recovery and rebuilding efforts. Transportation and other infrastructure opportunities are expected to increase and E&E is positioning to secure more opportunities in this area however the sector is very competitive.

The South American economy and business climate is slowly recovering and we're experiencing an increase in opportunities and are securing new business in Brazil, in Peru, and in Chile as well. The moderately strong market outlook for Chile could be tempered by results of the upcoming national election. Let's go to slide six.

Slide six shows our backlog at the end of the first quarter of this fiscal year compared with the end of the fiscal year 2017 and the end of the first quarter 2017, fiscal year 2017. As you can see, both the firm backlog, and the backlog expected to be delivered within the next 12 months have grown modestly over the past year. Let's go to slide seven.

E&E continues to work toward our strategic objectives with the forward view for alignment with marketplace opportunities we see being important for our future within the next three to five years, and for achieving both organic growth and growth by acquisition. Energy, and civil infrastructure, water, coastal restoration, and new technology applications for data management, and decision support tools are among important focus areas for us in our strategic initiatives as are focus on specific geographic regions of opportunity within the U.S. primarily.

In addition to exploring opportunities for M&A, we are putting great emphasis on recruiting new talent into the company thus enhancing our technical capabilities and our business development leadership for opening up new sectors, subsectors, and services in areas of strategic interest. Importantly at the corporate leadership level, we've been bringing in talent from the outside to double down on carrying out our strategic plan.

Senior people coming into the firm have backgrounds and experience in executing on initiatives for developing new market opportunities and achieving the benefits of growth. In the first quarter, E&E hired a Senior Vice President of Corporate Development who is leading a focused program for us to achieve strategic objectives in the areas of M&A and strategic hires. Let's go onto slide eight.

In summary, despite continuing challenges for our U.S. operations, our fundamentals remain strong. Results from our South American operations are improving. We've seen modest improvement in our backlog despite challenging marketplace conditions.

Our liquidity continues to improve. We have approximately $16 million available operating cash as of the end of the first quarter of fiscal year 2018. We have $39.5 million total lines of credit of which $37.4 million is available. We've paid 60 consecutive dividends since 1987 and our current dividend yield is around 3.8%.

This concludes our prepared remarks and we will now open up the call to your questions.

Operator (Operator Instructions)
Randall Mehl, Stewardship Capital.

Randall Mehl: Good afternoon. Thanks Gerry and John for doing this call. It's a good practice and appreciate the visibility here. Also, just good management job in the quarter managing to gross margin and free cash flow. Nicely done. I want to understand the shift in decision-making, and the delays that that's causing at the federal government level. But what types of projects are contributing particularly in the U.S. today to your business? Like where are you getting the business today, primarily?

Gerry Gallagher: Well, I would say we're diverse. We do a lot of different types of work from a pretty broad client base. But I would say the big contributors in the first quarter were in the legacy pollution cleanup programs with the State and federal agencies as well as in the energy sector, energy development projects that we're working on now were the bigger contributors.

Randall Mehl: And when you look at the U.S. in the backdrop and I understand the factors that you've laid out, but what would cause you to become more optimistic about new business in the U.S.?

Gerry Gallagher: Well, factors along those lines would include more secure funding sources for government work coming online. I would say the continued trend towards State and local funding of government projects, particularly in the infrastructure and restoration areas we feel was very important and we'd like to see more there and I would say more certainty in federal government policies, including the passing of tax reform legislation.

Randall Mehl: On the Harvey and Irma comment, what was the revenue impact from Harvey and Irma in Q1 if you can quantify that?

Gerry Gallagher: We quantify the impact at about roughly $300,000 of revenue. Some of that was lost and some of that was delayed and we'll see that revenue on the second and third quarter.

Operator (Operator Instructions)
David Cohen, Minerva Advisors.

David Cohen: Obviously, we've had sharp improvement in the cash balance over the last several quarters, and some of that is coming from earnings but an awful lot of that is coming from sort of rationalizing some of the working capital accounts and I'm just wondering if you can give us a sense as to how far through that process we are, whether there is more cash to sort of squeeze out of working capital or whether we're sort of where we're going to end up at this point.

John Mye: We continue and it has been an ongoing effort for the last two fiscal years, three fiscal years really is to continue to improve and reduce our fixed operating expenses was always going to be a continuing trend and an effort on the part of the team here to improve operating cash flow, if you will. And there's always a continuing desire on the part of the company; senior management both here in the U.S. and then our subsidiaries to reduce working capital.

This is very working capital intensive business as you know David in terms of our receivables, and contract receivables. And so the quicker that we can get those invoices paid by our clients, the better off we are. So I fully expect that there's always room for improvement in both of those areas.

Operator: Edward Kissel, Forager Capital.

Edward Kissel: First one for me is we understand that the environment is little difficult and if we just assume that it remains difficult with deferred decisions and deferred funding, it seems like if you could get some market share going in your favor you can still be able to grow. So I would love some discussion about what kind of levers you could pull and what kind of strategies you might be able to employ to show some growth even in a difficult environment maybe over the next couple, three, four years.

Gerry Gallagher: Well, right now one thing we're doing along those lines is focusing our business development areas toward those sectors where we see the greatest opportunity. We're looking at ways, developing ways, and deploying ways of improving our service offerings to offer more in those areas that are active particularly in the energy development areas, and we're hiring talent into our company. We're bringing in folks that have the technical backgrounds and leadership to help us open doors into some of the other sectors where historically we've had less involvement, where we can take what we're good at, and deployed into areas such as transportation.

We feel we could do more in that sector if we put some focus to it. It's an active sector. We believe there's going to be investment there going forward and we seek to be a part of that. So bringing in talent that's got the wherewithal, and the background, the relationships to lead us into some of these other areas. Energy has been at the core of our business, but there are now other areas in the infrastructure area, you know, in water transportation where we believe we could do more and so that's an emphasis we put on that in our business development efforts and in our talent development efforts for getting more.

Edward Kissel: That sounds great. I mean, I love that kind of thinking and I did want to congratulate you on the working capital effort to generate basically 10% of your market cap and free cash flow in one quarter is a huge achievement especially in a tough environment. So that's fantastic and I love the commentary that you just gave and the thoughts on continued focus there. Can you talk about maybe M&A is on the -- but now it seems like the greater focus with the new guy who's looking there more actively, how would you evaluate an acquisition? What kind of things are you looking for and how do you decide how much to pay and if it's the right fit?

Gerry Gallagher: Well, we're pretty active in that. We've been out talking with a lot of companies and developing relationships and looking to do some good work in the area. As I mentioned in our prepared remarks, the number of areas where we're focused right now where we see opportunities for growth over the next few years certainly strategic hires are important. Getting some talent leadership in our company to help us down those pathways, but we're looking at M&A as a component as well.

So there are, in certain sectors, service lines. We see an acquisition could help us. Also in terms of the geography of opportunities getting more out of locations where we are or establishing ourselves in some new geography where we can participate and have a shot at getting some additional business in these areas.

So it's sector and service-oriented. It's geographic-oriented. There's a number of companies we've looked at that have the components that we feel could help us with the synergy and so forth. Acquisition and integration of acquisition is very much a cultural issue. We're interested in companies that'll be a good fit with us where we can some synergies going both ways. Get the efficiencies, get the synergies out of that sort of thing, and we see that as that's an important part of the mix of what we're doing in terms of our growth strategy, and we're working hard on it.

Operator: This does conclude our Q&A session for today. I'd like to give the call back over to Mr. Gerry Gallagher for any closing remarks.

Gerry Gallagher: Thank you, everyone, for being on this call today. We really appreciate it and appreciate your interest in Ecology and Environment, and look forward to speaking with you again next quarter, and happy holidays.

Operator: Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program. You may now disconnect.