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Q3 2019 MYR Group Inc Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to the MYR Group Third Quarter 2019 Earnings Result Conference Call. Today's conference call is being recorded.

At this time for opening remarks and introductions, I would like to turn the conference over to David Gutierrez of Dresner Corporate Services. Please go ahead, David.

David E. Gutierrez ***Dresner Corporate Services, Inc. - Head of PR Practice and SVP***

Thank you, Markalin. And good morning, everyone. I'd like to welcome you to the MYR Group conference call to discuss the company's third quarter results for 2019, which were reported yesterday.

Joining us on today's call are Rick Swartz, President and Chief Executive Officer; Betty Johnson, Senior Vice President, Chief Financial Officer and Treasurer; Tod Cooper, Senior Vice President and Chief Operating Officer of MYR Group's Transmission and Distribution segment; and Jeff Waneka, Senior Vice President and Chief Operating Officer of MYR Group's Commercial and Industrial segment.

If you did not receive yesterday's press release, please contact Dresner Corporate Services at (312) 726-3600, and we will send you a copy or go to the MYR Group website, where a copy is available under the Investor Relations tab.

Also a replay of today's call will be available until Thursday, November 7, 2019, at 12:00 p.m. Eastern Time by dialing (855) 859-2056 or (404) 537-3406 and entering conference ID 2563913.

Before we begin, I want to remind you that this discussion may contain forward-looking statements. Any such statements are based upon information available to MYR Group management as of this date, and MYR Group assumes no obligation to update any such forward-looking statements. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from the forward-looking statements.

Accordingly, these statements are no guarantee of future performance. These risks and uncertainties are discussed in the company's annual report on Form 10-K for the year ended December 31, 2018, the company's quarterly report on Form 10-Q for the third quarter of 2019 and in yesterday's press release.

Certain non-GAAP financial information will be discussed on the call today. A reconciliation of these non-GAAP measures to the most comparable GAAP measures is set forth in yesterday's press release.

With that said, let me turn the call over to Rick Swartz.

Richard S. Swartz ***MYR Group Inc. - President, CEO & Director***

Thanks, David. Good morning, everyone. Welcome to our third quarter 2019 conference call to discuss financial and operational results. I will begin by providing a brief summary of the third quarter results, and then turn the call over to Betty Johnson, our Chief Financial

Officer, for a more detailed financial review. Following Betty's discussion, Tod Cooper and Jeff Waneka, Chief Operating Officers for our T&D and C&I segments, will provide an industry outlook and discuss some of MYR Group's opportunities going forward. I will then conclude with some closing remarks and open the call up for your comments and questions.

Our third quarter 2019 results included record-high revenues as well as improvements in net income, earnings per share and EBITDA compared to the same period of 2018.

We also reached a record high backlog of $1.37 billion. We understand that market leadership can only be achieved through our ability to adapt to our clients' needs, innovate and stay agile in tomorrow's world. Conventional client relationships have evolved as projects have become more complex, and we have placed a greater emphasis on collaboration, communication and problem-solving with all of our clients. MYR Group's geographic scale, depth of expertise and client-focused mindset continue to deliver sound financial results that form the foundation for consistent, long-term success.

We have initiated training programs that address the current and future needs of our customers, and we have implemented a universal project management training program for our next generation of leaders.

Industry developments continue to be defined by headlines related to clean energy as well as ongoing trends in customer spending for electrical infrastructure. The need to meet clean energy goals, relieve congestion, strengthen the grid and replace aging infrastructure are key priorities. We expect that output from these developments, along with a strong economy, will continue to present array of diversified opportunities in the markets we serve.

Overall, we know MYR's greatest strength lies in the diversity and the dedication of our talented professionals. Our reputation is built through their exceptional work and commitment to both our clients and communities. Through our focus on employee training and development, we support fulfilling careers that allow our employees to reach their full potential and make a genuine difference.

Now Betty will provide details on our financial results for the third quarter of 2019.

Betty R. Johnson ***MYR Group Inc. - Senior VP, CFO & Treasurer***

Thank you, Rick, and good morning, everyone. On today's call, I will be reviewing our quarter-over-quarter results for the third quarter of 2019 as compared to the third quarter of 2018.

Our third quarter 2019 revenues were $583.2 million. This represents an increase of $183.7 million or 46% compared to the same period last year and a record high for both segments.

Notably, even if we exclude the $65 million in incremental revenue from our recent acquisition of CSI, our C&I segment would still have reached record quarterly revenues.

T&D revenues were $294.9 million, up 32.5% compared to the same period last year. The breakdown of T&D revenues were $196.1 million for transmission and $98.1 million for distribution.

The T&D segment revenues increased primarily due to the increase in revenue on small- to mid-sized transmission projects. Approximately 40% of our third quarter T&D revenues related to work performed under master service agreements.

C&I revenues were $288.3 million, an increase of 62.9% compared to the same period last year. The C&I segment revenues increased due to the increases in volume across all project sizes and the incremental revenues from the CSI acquisition. Excluding the CSI acquisition, C&I 2019 third quarter revenues grew approximately 26% from the prior year.

Our gross margin was 10.2% for the third quarter of 2019 compared to 11.3% for the same period last year. The decrease in gross margin was primarily due to projects that we continue to carry at lower-than-historical margins for which we're pursuing additional compensation.

Additionally, gross margin included changes in estimates on certain contracts associated with recent acquisitions, which are subject to margin guarantees and represent potential consideration for which an offset is recognized in other expense.

These changes and estimates during the third quarter of 2019 and 2018 were $1.1 million and $2.3 million, respectively. The third quarter of 2018 was also positively impacted by a high volume of small changes in estimates in gross profit, which we -- did not reoccur in the third quarter of 2019.

SG&A expenses were $41.7 million, an increase of $10.5 million compared to the same period last year. The increase was primarily due to the acquisition of CSI along with higher employee-related expenses to support operations. SG&A as a percentage of revenue decreased to 7.1% for the quarter, which reflects a favorable impact from the record high sales compared to 7.8% in the prior period.

The CSA acquisition was cash flow positive for our operations but was not accretive for the first quarter after the acquisition, as previously indicated. The CSI operations generated a loss after taking into consideration the $1.1 million of contingent -- consideration from margin guarantee provisions and additional noncash amortization of $1.1 million. We expect the CSI operation to be accretive after the first year of operations.

Third quarter 2019 net income attributable to MYR Group was $10.4 million or $0.62 per diluted share compared to $8 million or $0.48 per diluted share for the same period last year.

Total backlog as of September 30, 2019, was $1.37 billion, a record high, and was 24.5% higher than a year ago.

Total backlog as of September 30, 2019, consisted of $463.8 million for the T&D segment and $902.3 million for the C&I segment. This represents another record high for the C&I backlog, even after excluding the additional backlog acquired in the CSI acquisition.

Turning to the September 30, 2019, balance sheet. We had approximately $245.9 million of working capital, $178.2 million of funded debt and $229.3 million of availability under our credit facility.

During the third quarter, we completed an amendment, restatement and expansion of our credit facility, which now has a $375 million capacity.

We believe that our credit facility, strong balance sheet and future cash flow from operations will enable us to meet our working capital needs, equipment investment, growth initiatives and bonding requirements.

In summary, we had improvements this quarter in revenue from both our T&D and C&I segments, net income, earnings per share, EBITDA and backlog compared to the prior year and to the prior quarter.

I'll now turn the call over to Tod Cooper, who'll provide an overview of our Transmission and Distributions segment.

Tod M. Cooper ***MYR Group Inc. - Senior VP & COO of Transmission and Distribution***

Thanks, Betty, and good morning, everyone. Our solid financial performance in the third quarter of 2019 demonstrates our strength in winning and executing T&D projects in a healthy market environment.

Bidding and performing projects of varying sizes and complexities reflects our ability to provide clients with a range of expertise in the markets we serve. We are driving growth through organic strategies that enhance our range of services while continuing to place our clients at the center of everything we do.

In the East, we continue to bid work for long-term clients. We were awarded Dominion's Valley to Dooms 500kV Transmission Line project and the Hopewell to Chesterfield 230kV double-circuit rebuild project and are nearing completion on the Cunningham to Dooms 500kV Line.

Throughout the Midwest, Texas and South, we're performing a variety of transmission, substation and distribution projects through direct awards and master service agreements for many customers.

In the West, solid bidding and project activity continues in Arizona, California, Colorado and Utah. We are positioned to capture some key projects to finish out 2019 and contribute to our backlog at the start of 2020.

In Arizona, we're strengthening capabilities in substation construction as many opportunities exist. Work remains robust in Colorado and in California as we signed extended master service contracts with Southern California Edison through the end of 2021 and Xcel Energy through mid-2022.

Work also continues on the Gateway West substation projects for PacifiCorp, which includes the Jim Bridger, Aeolus and Anticline substations.

On the distribution front, as utilities are increasingly reliant on outside contractors for work, we continue to execute work under long-term master service agreements with several utility clients. We expect a steady stream of distribution work for the foreseeable future as the need for grid hardening continues. Continued growth investment in clean energy dominated industry news throughout the third quarter.

Associated interconnections, expansions and upgrades of transmission infrastructure will be required for clean energy facilities, which we expect to present increased project opportunities.

In July, FERC announced that the pace of U.S. renewables growth is going to surpass fossil fuel growth by a greater margin than what they had anticipated as recently as April of this year.

First latest energy infrastructure update indicated that the fossil fuel dip will be largely driven by the more than 4.6 gigawatts of coal forecasted for retirement and that new renewable energy capacity is expected to grow by more than 10% in 2022.

The revision in FERC's latest projections underscores the dramatic changes taking place in our nation's generating mix, which presents opportunities for MYR Group throughout the country.

New data released by the American Wind Energy Association in August indicated that wind farm development activity rose to a new high in the second quarter of 2019. The report noted a 10% increase in activity when compared to the same time last year. The wind industry is expanding across the U.S. with more than 200 wind projects underway in 33 states.

A handful of long-term clients announced initiatives related to clean energy investments throughout the third quarter.

NextEra Energy Resources announced in July, it will develop the Skeleton Creek project, the largest hybrid renewable project in the United States. It will consist of a 700-megawatt facility in Oklahoma that will serve 21 utility members and other customers of Western Farmers Electric Cooperative, and will include 250 megawatts of wind, 250 megawatts of solar and a battery storage project.

The combined wind, solar and energy storage facility is the first of its kind announced in the Southwest Power Pool.

PSEG announced, it is on track to cut carbon emissions by 80% by 2046 relative to 2005 levels. PSEG will also retire or sell all remaining interest in coal-fired power plants with no plans to build or acquire new fossil fuel generation. PSEG is a leading developer in solar resources and is an active supporter of offshore wind development in New Jersey.

In September, Duke Energy committed to neutralizing its carbon emissions entirely by 2050 and cutting emissions in half by 2030. The utility plans to double its renewable energy portfolio by 2025, up 10% from previous goals. These developments are encouraging as we continue to refine and expand our clean energy offerings across the broader geographic footprint, positioning MYR to be a contractor of choice for these developments.

As we expand our capabilities, we must do so knowing that today's customers are expecting more. To remain a premier contractor of choice, we must consistently evaluate and invest in new efforts to improve the levels of service and value we provide in terms of safety, quality and productivity.

In summary, we believe the T&D market holds tremendous opportunity, and we will continue to devote ourselves to innovate, invest and transform our business to bring the best of MYR Group to our customers, employees and shareholders.

I'll now turn the call over to Jeff Waneka, who will provide an outlook of our commercial and industrial segment.

Jeffrey J. Waneka ***MYR Group Inc. - Senior VP and COO of Commercial & Industrial***

Thanks, Tod, and good morning, everyone. We experienced incremental financial improvements in the third quarter, which resulted in better financial outcomes than in the first 2 quarters of 2019. We improved quarterly growth in revenue, operating margins and backlog.

Turning to backlog. Our commercial and industrial backlog expanded throughout most of our locations, and we also benefited from a large backlog increase from newly acquired CSI.

We are pleased with the strategic fit of the project awarded this quarter in our primary markets of aviation, transportation, high tech, water treatment, warehousing, renewable energy, as these markets specifically continued to show positive economic forecast, and we're, again, the major contributors to this quarter's backlog.

We've put a great deal of effort into building sustainable long-term relationships in each of these markets, which we believe has contributed to our continued momentum over several quarters. Our training programs are specifically designed to broaden our skills in these specific industries, and combined with our already deep resume give MYR Group subsidiaries, a distinct advantage in capturing these highly technical projects.

Last quarter, we announced the acquisition of CSI, and I shared our confidence in the talent that has joined our company. Along with an important cultural fit, I'm looking forward to the abundant opportunities to expand our preconstruction services, client relationships and innovative installation methods as we merge our industry-leading companies.

CSI along with MYR Group subsidiaries have a talented pool of employees in all departments. As we continue integration, we are even more pleased about our alignment around the welfare of our employees, advancements in technologies and delivering a high-quality and cost-effective product that drives benefit for all.

In addition to this quarter's awarded projects, we're thrilled with the size, number and quality of the pursuits being discussed in many of our C&I offices, leading to continued confidence in our view of the market.

Our renewable energy portfolio continues to expand as we've gone under contract on solar projects of various sizes in both California and New Jersey, 2 states with aggressive mandates to advance their use of alternative energy.

We're also excited that the client relationships gained through Huen and CSI are increasing dialogue and opportunity in the emerging battery storage industry. We believe as battery storage continues its evolution into an increasingly feasible method to deploy distributive energy, our unique position as a combined C&I and T&D specialty contractor will become an ever-increasing distinct advantage for our clients who are developing these next-gen projects.

In addition to the wealth of experienced energy professionals already employed by our subsidiary companies, we've been pleased to recruit new leadership from the renewable industry to bolster our pursuits in the renewable energy field.

To wrap this up, we expect to see steady bidding activity through the remainder of 2019 and into early 2020.

Project opportunities are healthy in all markets across most of the U.S. and Canada. We've won a wide variety of small- to mid-sized projects in commercial, industrial and transportation. Our research indicates that this market should remain resilient through 2019 and beyond.

Thanks, everyone, for your time today. I'll now turn the call back over to Rick, who will provide us with some closing comments.

Richard S. Swartz ***MYR Group Inc. - President, CEO & Director***

Thank you for those updates, Betty, Tod and Jeff. I'm proud to serve as MYR Group's President and CEO. I'm truly inspired by our people, by the projects we deliver for our clients and the industry reputation we've built together.

We remain committed to delivering excellent shareholder value and doing so through ethical, sustainable and safe working environments.

In closing, I'd like to thank our employees for their dedication and loyal clients and stockholders for their trust and support.

Operator, we are now ready to open the call up for comments and questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Sean Eastman of KeyBanc Capital Markets.

Sean D. Eastman ***KeyBanc Capital Markets Inc., Research Division - Senior Equity Research Analyst***

I guess the one thing that stood out in my model in the quarter was just this uptick in the transmission revenue run rate. I was hoping to just get a little more color for exactly what's driving that healthy increase in revenues versus 2Q? And maybe just, kind of, the duration on the projects that are driving that? Just to get a sense for just how revenues are trending overall in transmission.

Tod M. Cooper ***MYR Group Inc. - Senior VP & COO of Transmission and Distribution***

I think -- this is Tod. Revenues are trending well. In the quarter, we did have a few medium-sized projects that were getting started, that did have some large material subcontract components as well. But the consistency of the market's still there on the T&D side, transmission, small- to medium-sized projects are out there. There are several in the bidding stages right now. And as I mentioned in the script, we think that there's a good chance we're going to capture some in the fourth quarter as well as that helping our backlog at the beginning of 2020 as well.

Sean D. Eastman ***KeyBanc Capital Markets Inc., Research Division - Senior Equity Research Analyst***

Okay. And then just staying on the T&D segment, the other thing that was -- little offers that were forecast was the margins in T&D were lower than we expected. I just wondered in light of the project mix and jobs ramping up and subcontractor material components, just directionally, where are we headed from here relative to that, kind of, 6% to 9% operating margin target you guys have out there for the segment?

Richard S. Swartz ***MYR Group Inc. - President, CEO & Director***

This last quarter, we had a few impacts on a few projects that we're going -- we're currently negotiating change orders on. So hopefully, those will get settled. I don't know if they'll get settled by year-end. It's really just ongoing conversations as these projects progress, really the normal course of business, so that had a slight draw because we don't take everything that we think we'll get. We always leave a little room to negotiate and come out with something that's fair for both sides. These are long-term clients. So that had an impact on it. That was really the biggest driver as we went through. Going forward as we look at it and we discuss it as a team and we look at what's viable out there to come to market for us, we see some good opportunities, and we see ourselves pushing to get ourselves back up from where we're at today to those more normalized operating margins.

Sean D. Eastman ***KeyBanc Capital Markets Inc., Research Division - Senior Equity Research Analyst***

Okay, great. And then last one for me, just considering the CSI -- recent CSI acquisition, it was pretty large for you guys. Just wanted to get an update on capital allocation priority over the next 12 months. I'd assume you guys would be looking to pay down some debt. But other than that, just wondering if we could see more acquisitions, if you guys are looking at some share buybacks. Any color there would be great.

Betty R. Johnson ***MYR Group Inc. - Senior VP, CFO & Treasurer***

Yes, I can take that. This is Betty. When it comes to the capital allocation, I think we've even talked this last quarter as the CSI acquisition came through, our focus with our free cash flow is to address our overall leverage and getting it back into the levels that we historically had operated at prior to going to the point of another acquisition. That looks like it will be in 2020, probably more of a hiatus and focused on that CSI integration as well as other organic growth initiatives internally. While we get the balance sheet at that point, stock buybacks, as you know, our stock buyback program, we have not renewed. We look at that every quarter. However, our focus on the balance sheet is getting the debt paydown and the leverage. We're below that range of our tolerance up to 2x EBITDA, but we're still looking to reduce the debt back to the norms that we had at 1.2 or so. Rick, anything else?

Richard S. Swartz ***MYR Group Inc. - President, CEO & Director***

No, I think, Betty, you covered it well. Again, lots of opportunities out there. If we choose to do an acquisition in the future, I think there's a good pipeline out there. But really, we don't need one to succeed, we can really focus on, as you said, our organic growth and that focus on building our base business going forward.

Operator

(Operator Instructions) I am showing no further questions at this time. I would now like to turn the -- we do have a question from the line of Noelle Dilts from Stifel.

Noelle Christine Dilts ***Stifel, Nicolaus & Company, Incorporated, Research Division - VP & Analyst***

I apologize, I'm popping in here really late. So you may have already touched on this, but did you give -- did you provide any additional detail on how to think about the cadence of the intangibles amortization associated with CSI, as not just over the next 12 months, but is most of that burning off? Or how does that carry into, kind of, the back half of '20 and '21?

Betty R. Johnson ***MYR Group Inc. - Senior VP, CFO & Treasurer***

So $1.1 million that we have in there for this quarter is pretty similar level that you can expect for the next year. That includes our higher amortization for the backlog and that's the period that -- after that, it will start going down. Just like...

Noelle Christine Dilts ***Stifel, Nicolaus & Company, Incorporated, Research Division - VP & Analyst***

It will start going down?

Betty R. Johnson ***MYR Group Inc. - Senior VP, CFO & Treasurer***

Similar to here when -- yes, similar to here when -- where we had the large backlog for the first year, and then it went back down for the amortization that we'll take will go on for a long period of time.

Noelle Christine Dilts ***Stifel, Nicolaus & Company, Incorporated, Research Division - VP & Analyst***

Okay. And then just quickly, I guess, generally, we've been hearing comments and it seems to be consistent with what you all have said about just strength in the T&D market overall. And curious if you're seeing any tightness in terms of labor or holding on to crews? Or if the market is just not really quite at those levels yet?

Richard S. Swartz ***MYR Group Inc. - President, CEO & Director***

As far as labor goes, we really haven't had much problems for getting labor. I'll let Tod add to this a little bit. I think we've got the right safety. We've got the right equipment out there. We've got the right supervision, and people want to work with our team. So the availability of resources for us to attract is pretty strong. And we really haven't had -- we've never had to turn or weigh a job in the last year that we couldn't man or we couldn't go after, so we didn't have the possibility to bid it. We've been able to bid everything out there.

We're -- we've watched a little tighter and some markets that are a little tighter, and we're selective on which work we take on. But again, we haven't -- not been able to go after any work, and that goes for our T&D and C&I side.

Noelle Christine Dilts ***Stifel, Nicolaus & Company, Incorporated, Research Division - VP & Analyst***

Okay. And...

Tod M. Cooper ***MYR Group Inc. - Senior VP & COO of Transmission and Distribution***

I think that -- no, I was just going to add that right now what we've talked about the last couple of years is the delays and the pushing out of the large projects and should some of that come to light in '20 -- late 2020 or '21, it's certainly a concern that we've got our eye on, doing some -- taking some preventive measures to make sure that we have the resources available to handle our load.

Noelle Christine Dilts ***Stifel, Nicolaus & Company, Incorporated, Research Division - VP & Analyst***

Okay. That's helpful. And then I guess sort of along the same lines around capacity, potential capacity constraints. I think Valmont talked pretty openly about pretty -- very long lead times for some of the larger transmission towers. Does that impact how you guys are thinking about project schedules? And just when some of these projects occurred on the larger project side, do you think it basically extends the cycle a little bit because there are some of these capacity limitations out there?

Richard S. Swartz ***MYR Group Inc. - President, CEO & Director***

That's a very well-known situation throughout the industry. And one of the things that we're seeing today is longer lead times from award of project to actual construction. And that is one of the drivers some of the EPC work that we're bidding and some of the medium- to larger-sized projects that we're bidding now have much longer. I guess it's an advantage for us. It gives us more time to prepare for those projects after award, but we're seeing a longer gap from award to start of projects as a result of what you just mentioned.

Operator

(Operator Instructions) And I'm showing no further questions at this time. I would now like to turn the conference back to Mr. Swartz. Sir?

Richard S. Swartz ***MYR Group Inc. - President, CEO & Director***

Thank you, everyone, for participating on today's call. I don't have anything further. We look forward to working with you going forward and speaking with you again on our next conference call.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.