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Q3 2023 MYR Group Inc Earnings Call

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PRESENTATION

Operator

Good morning, everyone, and welcome to the MYR Group Third Quarter 2023 Earnings Results Conference Call. (Operator Instructions) Today's conference 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, 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 2023, which were reported yesterday.

Joining us on today's call are Rick Swartz, President and Chief Executive Officer; Kelly Huntington, Senior Vice President and Chief Financial Officer; Tod Cooper, Senior Vice President and Chief Operating Officer of MYR Group's Transmission & Distribution segment; and Don Egan, Senior Vice President and Chief Operating Officer of MYR Group's Commercial & 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 webcast replay of today's call will be available for 7 days on the Investors page of the MYR Group website at myrgroup.com.

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's 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, 2022, the company's quarterly report on Form 10-Q for the third quarter of 2023, 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 2023 conference call to discuss financial and operational results.

I will begin by providing a summary of the third quarter results. And then we'll turn the call over to Kelly Huntington, our Chief Financial

Officer, for a more detailed financial review. Following Kelly's overview, Tod Cooper and Don Egan, Chief Operating Officers of our T&D and C&I segments, will provide a summary of our segment's performance and discuss some of MYR Group's opportunities going forward. I will then conclude today's call with some closing remarks and open the call up for your questions.

The strength of our long-term customer relationships and a strong market position resulted in a steady third quarter performance. Our teams continue to execute projects with operational excellence and expand existing client relationships through master service and alliance agreements across our districts.

Bidding activity remains healthy as we strategically pursue and capture new opportunities that position us for potential future growth. A growing demand for electrification, a continued emphasis on the clean energy sources and a focus on grid modernization and hardening continue to be strong market drivers and could present opportunities for consistent success across our business.

The 2023 North American Electric Transmission Forecast released in September by The C Three Group indicates a strong potential for healthy growth moving forward as electricity demand continues to increase across the country. The report projects $172 billion of spending on new transmission or upgrade over the next 5 years from the top 20 investor-owned utilities.

Carbon reduction goals and clean energy targets are other potential spend drivers in the T&D market. We continue to track these major transmission expansion projects and clean energy initiatives that may lead to future work opportunities and growth while remaining committed to executing existing projects for our valued customers.

In our C&I segment, industrial spend projections are positive in our key markets such as data centers, health care, transportation, and manufacturing even as the overall commercial market are forecasted to slow down into 2024. By expanding existing relationships with our preferred clients and strategically bidding and expanding work in our chosen markets, we continue to experience a steady backlog of work and could see potential growth moving forward.

The commitment and solution-oriented mindset of our people allows us to remain at the forefront of the industry, and provide our clients with excellent service and customer experience, backed by safe and reliable execution. Our steady third quarter performance is a result of their tireless efforts and I would like to thank them for the fostering of strong culture.

Now, Kelly will provide details on our third quarter 2023 financial results.

Kelly Michelle Huntington ***MYR Group Inc. - Senior VP, CFO, Principal Financial Officer & Principal Accounting Officer***

Thank you, Rick, and good morning, everyone.

Our third quarter 2023 revenues were $939 million, a record high, which represents an increase of $140 million, or 17% compared to the same period last year.

Our third quarter T&D revenues were $549 million, a record high for our T&D segment and an increase of 21% compared to the same period last year. The breakdown of T&D revenues was $358 million for transmission, and $191 million for distribution, both records.

T&D segment revenues increased due to higher revenue on transmission projects, primarily related to higher revenue on clean energy projects. Work performed under master service agreements continue to represent approximately 50% of our T&D revenues.

C&I revenues were $391 million, a record high for our C&I segment, and an increase of 12% compared to the same period last year. C&I revenues increased primarily due to higher revenue related to clean energy projects in certain geographical areas.

Our gross margin was 9.8% for the third quarter of 2023, compared to 10.8% for the same period last year. The decrease in gross margin was primarily due to labor and project inefficiencies. Some of which were caused by supply chain disruptions and inclement weather. Gross margin was also negatively impacted by rising costs associated with inflation. These margin decreases were partially offset by favorable change orders and better-than-anticipated productivity on certain projects.

T&D operating income margin was 6.6% for the third quarter of 2023, compared to 7.6% for the same period last year. The decrease was primarily due to labor and project inefficiencies, mainly related to clean energy projects as well as inclement weather. These decreases were partially offset by better-than-anticipated productivity.

C&I operating margin was 3.6% for the third quarter of 2023, compared to 3.1% for the same period last year. The increase was primarily due to favorable change orders and better-than-anticipated productivity on certain projects. These increases were partially offset by labor and project inefficiencies, all of which were caused by supply chain disruptions and inclement weather. C&I operating income margin was also negatively impacted by rising costs associated with inflation.

Third quarter 2023 SG&A were $60 million, an increase of $1 million compared to the same period last year. The increase was primarily due to higher employee incentive compensation costs and higher employee-related expenses to support the growth in our operations.

Third quarter 2023 interest expense was $1 million, an increase of $200,000 compared to the same period last year. The increase was primarily due to higher interest rates partially offset by lower average debt balances during the third quarter of 2023 as compared to the same period last year.

Third quarter 2023 net income was $22 million, compared to $18 million for the same period last year. Net income per diluted share of $1.28 increased 17% compared to $1.09 for the same period last year.

Third quarter 2023 EBITDA was $47 million compared to $40 million for the same period last year. Total backlog as of September 30, 2023, was $2.62 billion, 6% higher than a year ago. Total backlog as of September 30, 2023, consisted of $1.14 billion for our T&D segment, and $1.48 billion for our C&I segment.

Third quarter 2023 operating cash flow was $13 million compared to operating cash flow of $14 million for the same period last year. Third quarter 2023 free cash flow was negative $10 million compared to free cash flow of negative $4 million for the same period last year, with the decrease primarily due to higher capital expenditures to support our continued growth.

Moving to liquidity and our balance sheet. We had $292 million of working capital, $62 million of funded debt and $432 million in borrowing availability under our credit facility as of September 30, 2023.

We have continued to maintain a strong funded debt-to-EBITDA leverage ratio of 0.33x as of September 30, 2023. We believe that our credit facility, strong balance sheet and future cash flow from operations will enable us to meet our working capital needs, support the organic growth of our business, pursue acquisitions and opportunistically repurchase shares.

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

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

Thanks, Kelly, and good morning, everyone.

Our T&D segment steady financial performance in the third quarter demonstrates the strength of our long-term customer relationships and the reliability of our sound business principles.

Our districts continue to maintain and expand strong client relationships, while a healthy bid environment and strategic wins throughout our markets have produced a very nice backlog of work.

As Rick mentioned, we're seeing significant investments in electrical infrastructure throughout North America, including many transmission upgrades, substation expansions and distribution partner programs.

According to the 2023 North American Electric Transmission Forecast recently released by The C Three Group, the total electric transmission capital spend in 2022 was over $43 billion, and is forecasted to grow as high as $67 billion in 2027. This investment is expected across the country with Texas and California, 2 focus areas for MYR Group having the highest planned transmission capital expenditures.

The report also indicated that significant load growth driven by hyperscale data centers is increasing the need for additional substation infrastructure and transmission interconnections around North America.

Overall, The C Three report stated that investor-owned utilities represent roughly 60% of the total U.S. electric transmission market, and it is considered the most stable and predictable of all sectors.

The need for new and upgraded electrical infrastructure has the potential to create future opportunities for our business.

Our traditional T&D operations continued their strong execution of work throughout our operating territories. Our Eastern region was awarded multiple transmission line projects as well as substation expansions and upgrades to the third quarter. Considering the L.E. Myers Company extended several master service agreements in multiple districts and continues to bid others, while E.S. Boulos and Harlan Electric executed 3 around that setting.

In our Western region, we continue to expand work with trusted long-term clients, including a fast-track storm damage transmission line repair project in Texas by Great Southwestern Construction.

Rising labor costs and project inefficiencies, some weather related and most notably in the solar market persisted across the segment. These along with supply chain disruptions impacted financial results for Q3. While we see rising labor costs stabilizing, our strategic insight survey appliance conducted this year shed some light on supply chain constraints our clients face. To help mitigate supply chain constraints, our clients are expanding their roster of suppliers and working diligently with them to form better working relationships.

MYR Group also continues to work in close collaboration with our robust network of vendors and our customers to help mitigate supply chain challenges and advance projects to successful completion.

In summary, our T&D segment remains committed to partnering with our valued customers, safely provide excellent project delivery, while strengthening and expanding those relationships for mutually beneficial outcomes.

And thank you to our talented employees for helping us reach our high-quality standards every day. We are excited about the outlook of the T&D industry, and look forward to playing a key role in helping to meet the future demand in North America.

I will now turn the call over to Don Egan, who will provide an overview of our Commercial & Industrial segment.

Don A. Egan ***MYR Group Inc. - Senior VP & COO of Commercial and Industrial***

Thanks, Tod, and good morning, everyone.

The third quarter saw steady performance in the C&I segment as we continue to strengthen and leverage strong relationships with our valued customers, while professionally executing projects and strategically bidding opportunities in our chosen core markets.

As Rick mentioned earlier, while overall commercial spending is forecasted for a slight slowdown going into 2024, there are positive signs of growth in our chosen markets such as data centers, health care, transportation, and manufacturing.

The consensus construction forecast from the American Institute of Architecture released in July projects growth in industrial construction spending into 2024, particularly in public safety with a forecasted 5.3% increase, and health care at a projected 3% increase.

Data centers remain an active and high-demand market due to shifts toward hybrid cloud environments and increasing use of artificial intelligence, and forecasts predict record growth in the market.

According to a report from McKinsey & Company released earlier this year, demand for data center projects is forecasted to grow by 10% year-over-year, reaching 35 gigawatts by 2030, more than doubling current consumption.

These encouraging forecasts could generate growth for our business, and we continue to leverage our expertise to place us in a leading position to win opportunities in these markets.

Our backlog of work remains steady in the C&I segment, thanks to strong long-term relationships with clients, and our subsidiaries continue to see healthy bidding activity in key markets across North America.

Transportation projects remain underway in Colorado and Vancouver as well as data center build-outs and upgrades across our C&I business.

Sturgeon Electric continues to execute pharmaceutical projects in Colorado, while closely monitoring opportunities for additional battery storage, solar and electrical vehicle charging station projects.

CSI Electrical Contractors and Huen Electric continued to serve clients in the clean energy space, executing both solar and energy storage work, while also seeing solid bidding opportunities for additional work in those markets.

Supply chain and material headwinds persist in the C&I segment. Although we have seen some improvements in the second half of '23, we continue to work closely with our vendors and clients to mitigate these challenges and best serve them with exceptional project delivery.

It's thanks to the tireless effort of our experienced and committed employees that we continue to overcome obstacles, maintain a healthy pipeline of work and remain a trusted and agile partner for our valued customers. I would like to thank all of our employees for their hard work and placing us in a position to succeed.

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

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

Thank you for those updates, Kelly, Tod and Don.

Our third quarter 2023 performance illustrates the strength of our core markets, our ability to maintain and expand long-term customer relationships, and our ongoing commitment to strong operating principles and sound business strategies.

We recognize the importance of adapting to market conditions and being an agile partner for our customers as we respond to industry changes. This is supported by our continued investment and development of our teams who enable us to maintain our status as an industry leader by the work they perform each day.

Thank you to every employee for your dedication and invaluable contributions to the organization. It does not go unnoticed.

And finally, I want to thank each of you for your continued support of MYR Group. We look forward to progressing our business strategies while emphasizing our client relationships and creating shareholder value.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Justin Hauke of the Baird Company.

Justin P. Hauke ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate***

Yes. I guess my first question here was you guys called out a 130 basis point impact to gross margin from the estimate revisions on your fixed price contracts. I guess, I was just hoping to get a little bit more detail on that. I mean, was that primarily weather-related as kind of a onetime thing for the quarter? And then also maybe the split between the segments, how that go through? I would assume it's mostly in T&D.

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

It was mostly in T&D and it was primarily on our solar side of the business, the clean energy side, where we had some weather impacts on projects. We had some, as Tod said in his script, some rising labor costs that affected us on a few projects and some design issues that we're working through. So that was primarily where it was at. The rest of the T&D performed pretty well as expected.

Justin P. Hauke ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate***

Okay. And then I guess maybe a follow-up to that is, just looking into 4Q, typically, seasonally, 3Q is a higher margin, more profitable quarter. But to your previous point, it sounds like there were some kind of onetime things here. But if I look at the estimates that are out there for 4Q, the EBITDA margins are materially higher than 3Q. So I guess, I mean, just the tenor of maybe the margin contribution that you would see out there. I mean is 3Q kind of unusually light, and maybe the better comparison for 4Q is kind of year-over-year?

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

I would look at it similar to probably where we were last year. I wouldn't look at it, maybe, where people are at today. We don't give guidance, but it seems like it's on maybe high side there when you compare it to where we're at, especially when we talk about the impacts that we've had on some of our clean energy projects on the T&D side that those that we think had stabilized, those will continue to carry out lower margins for the next quarter or 2 as we finish up those projects. But overall, it's still a very good strong market.

Justin P. Hauke ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate***

Okay. And then if I could just squeeze in one more for Kelly. The unbilled receivables balance has kind of been increasing. So the revenues on orders that are under negotiations, so that's increased to just under $60 million here, and it's been kind of steadily increasing in the last several quarters. Can you give any context as to what that's related to, and maybe the time line for resolution, and maybe a benefit to cash flow instead of the working capital drag that you've been having?

Kelly Michelle Huntington ***MYR Group Inc. - Senior VP, CFO, Principal Financial Officer & Principal Accounting Officer***

Yes, sure. Happy to talk about that. And maybe just to back up a little bit. So part of this comes down to just the growth of our company. So of course, as our revenues grow, unbilled revenues will also be likely to grow in some proportion to that.

A couple of other factors. Our DSOs have risen a bit from where we were at the end of last year, which was near record lows. And a couple of things have contributed to that. So one is really project timing. And I talked a little bit about this last quarter, that as we have projects that are wrapping up, we do start to build some balances related to contract retainage. And you can see that in the quarter. We were up another 12% in contract retainage versus the second quarter. So that is part of it.

The other, as I've talked about some of our mid- to large-size transmission and clean energy projects can have some pretty favorable billing profiles as we start those projects, and then those balance out as we wrap up.

And so that's also a bit of what was a positive for us in the fourth quarter of last year. And then in the second and third quarters has been a bit of a drag as we look at DSOs.

I think the good news, though, is that when you look at our DSOs relative to our peers, still in a pretty favorable position. And of course, we do recognize though that in a higher interest rate environment, our customers are just naturally likely to want to hang on to their money until the last minute when it's due and may start to push more on payment terms. So we, of course, keep a close watch on that.

But I think the good news is even with needing to have working capital to support our growing business, we still ended the quarter in a very minimal leverage position.

Operator

And our next question comes from Brian Russo from Sidoti.

Brian J. Russo ***Sidoti & Company, LLC - Equity Analyst***

If we could just focus on solar for a minute. The challenges facing that industry has been well publicized as of late, mostly due to rising interest rates, higher cost of capital, supply chain, inflation, headwinds.

And I'm just curious, what are you hearing or from your customers, whether it's on the C&I side or the T&D side, whether it's utilities or independent power producers or third-party developers. What are you seeing in the market? Because you referenced solar several times throughout your opening remarks as negatively impacting margins?

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

Yes. I think let's divide it into 2 things here. I think when we're talking future work in the market, we still see it as a very strong market going forward. But it's one that will continue to be very selective on as we pick up projects because of some of the impacts that you mentioned and we talked about in our script.

So we continue to see those impacts, and supply chain is an issue out there. I mean, materials are tighter and tighter in that marketplace because there's a lot going on worldwide in that market. Labor is always a concern and we'll grow steady in that market, like we are in our other markets and continue to push that side, but very cautiously. So I would say from a client standpoint, they're bullish on what's going forward. But again, we're going to be very selective going forward.

Brian J. Russo ***Sidoti & Company, LLC - Equity Analyst***

Okay. Great. And then just on the backlog, not necessarily sequential trends because I know start and stop the projects, it could create some lumpiness there. But when I look year-over-year, T&D is still up double digits each quarter this year. But it looks like C&I peaked up 12% in June year-over-year to the September quarter, which is up less than 2% versus September a year ago. And I am just wondering if you can give some more insight into that. And is that tied into your early comments of seeing some commercial slowdown as we move into 2024?

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

I would say, our markets are strong in what we're looking at. Again, as we said before, our backlog is always going to be lumpy. We're not trying to sign a contract and get it forced into our backlog for quarter end so we can report something higher. We want to make sure we have the right contract in place. And with higher risk interest rates and some of the terms and conditions we push for, sometimes it takes a little longer to push a contract forward or for them to get their budgets approved. But from a visibility standpoint, a very strong market out there going forward.

Brian J. Russo ***Sidoti & Company, LLC - Equity Analyst***

Okay. And then lastly, the operating cash flow relative to free cash flow, it looks like you're -- you have a free cash flow outflow for the first 9 months of the year. And I'm just wondering, I suppose that means we should see quite a meaningful improvement in free cash flow in the fourth quarter to kind of match generally your historical trends?

Kelly Michelle Huntington ***MYR Group Inc. - Senior VP, CFO, Principal Financial Officer & Principal Accounting Officer***

Sure. I'll address that one, Brian. So part of the negative free cash flow is the higher CapEx this year, which really aligns with the growth we're having, particularly on the T&D side of the business, as that is the more asset-intensive side of the business. So we do expect that to be a way that we'll continue to support our growth is investing in fleet and equipment.

So that's one aspect. The other is on operating cash flow and some of the dynamics I talked about in response to Justin's question, which really comes back to project timing being a big driver of that. So we do expect there are some retained balances that we'll bill and collect starting here in the fourth quarter, but some of that will also push into the first part of next year. So we do expect that, that will normalize over time, but it is a bit of an ebb and flow tying back to project timing.

Brian J. Russo ***Sidoti & Company, LLC - Equity Analyst***

Okay. Great. And then just lastly, you mentioned Texas and California as big markets on the transmission side. Are you seeing any movement or increased activity with utility transmission projects tied to the MISO Tranche 1 projects?

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

Yes, I'll take that Rick. Yes, we are. Actually, we've been bidding a few of those projects over the past year, and there's 3 of them out right now, and we're seeing more in the future. So that activity is picking up. And right now, like I said, we're pretty optimistic about where we stand, and our capabilities in that are aligned pretty well with a lot of those clients who are existing MSA partners. So that activity is picking up.

And I think I've mentioned in the past, Brian, that we're going to -- that kind of spread out evenly from 2020 through 2029 on the construction side of things.

Operator

(Operator Instructions) Okay. I'm showing no further questions at this time. I would now like to turn the call back to Rick Swartz, President and Chief Executive Officer of the MYR Group. Please go ahead.

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

To conclude, on behalf of Kelly, Tod, Don and myself, I sincerely thank you for joining us on the call today. I don't have anything further, and we look forward to working with you going forward, and speaking with you again on our next conference call. Until then, stay safe.

Operator

Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.