

Bowman Consulting Group Ltd Q1 2022 Earnings Webcast

Thursday, 12 May 2022

Gary Bowman Welcome to the Bowman Consulting Group First Quarter 2022 Earnings Call. I'm Gary Bowman, chairman and CEO of Bowman, joined here this morning by Bruce Labovitz, our chief financial officer.

Before we get started, I want to welcome everyone from McMahon Associates, the most recent addition to Bowman. The addition of this committed team of talented professionals is going to be transformative to our transportation practice as well as to our business overall. We're excited to have this transaction completed and we're really looking forward to the great work we're going to be doing together.

The first quarter of 2022 picked up where 2021 left off, generating record results for sales, revenue and adjusted EBITDA, and the Q1 momentum continues unabated into the second quarter.

During the quarter, we closed on a \$17 million equity raise, we booked over \$60 million in net new orders, and we produced record growths in net revenue. The growth was driven by every one of the markets served by our business.

Despite challenging world conditions, we continue to see multiple opportunities for profitable growth. Net service billings for the quarter increased 65% over the first quarter of 2021, with an organic growth rate of 36% over that period. During the quarter, we continued to see integration of seven acquisitions we made post-IPO, and we closed on an eighth, with Perry Engineering in Tucson.

A collaborative culture of cross-sharing and work-sharing generated meaningful revenue synergies between our acquisitions, our legacy operations and positively impacted the quarter results. Continuing to execute on our growth strategy, last week we closed on the transportation engineering firm McMahon Associates, which is our largest acquisition to date.

Within the first week, we've already realised over \$1 million of revenue synergy from this acquisition, through a new traffic study engagement with one of Bowman's longstanding quick-service restaurant clients. The financial impact of this one assignment alone essentially reduces the transaction multiple by nearly a full turn.

Gross revenue in the first quarter continued to be concentrated on our building infrastructure market, at just under 74%, followed by power and utilities at 14.5%, transportation at 7.5%, and emerging markets at 4%.

For the sake of illustration, on a pro forma basis, if the McMahon transaction had occurred on January 1st, transportation would have been about 18% of our gross revenue, and building infrastructure would have been 65%. McMahon is the first of a number of steps towards meaningful diversification of our business by way of larger acquisitions.

During Q1, building infrastructure grew by nearly \$18 million, or 84%, over the same period in 2021, with nearly equal growth between commercial and residential followed closely by public sector contracts. We continue to see healthy increases in quick-serve restaurant and commercial industrial projects along with bill-to-rent and residential inventory-creation for home-builders.

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Quick-serve restaurants represent a dependable source of repeat customer revenue, while development engagements like the Amazon HQ2 project in Arlington Virginia represent reliable long-term revenue. The demand for data centres and other industrial facility work is as high as it's ever been, with pricing power remaining in our favour.

Our current complement of building infrastructure clients and projects have so far proven to not be tightly correlated to interest rate movements, and we've not experienced any slowdown on activity or request for proposals.

Transportation's clearly in a transition at the moment at Bowman. While down slightly this quarter over the last year, were confident between the McMahon acquisition and the upcoming spending we expect to begin later this year and next, and the infrastructure bill, this trend will quickly reverse course, and that transportation will increasingly become a more meaningful component of our revenue over the next year.

Our work on the Mile Long Bridge and Burleigh Avenue projects continues to generate meaningful recurring revenue, and the Cook County Roadway construction management project is starting off in earnest this quarter.

The I-35 Northeast Expansion Projects in San Antonio will be gearing up for long-term recurring revenue over the next several years. I'm happy to report that Bowman was recently selected by the Illinois Tollway for the upcoming central Tri-State I-294 Project. We're negotiating the contract. I'll update you on that project on our next conference call.

Our power and utilities work grew 16% year over year, due in large part to increased spending on utility undergrounding and gas line engineering projects. We recently awarded a renewal in our long-term contract with Southwest Gas, and we continue to build on our long-term relationship with WEC Energy.

Most of our longstanding utility clients are looking to increase their spend with us substantially this year over last. The US power grid continues to face unrelenting pressure to increase resilience and reliability, replacing ageing infrastructure and integrated technologies such as electric vehicles, distributed generation, and battery storage. Spending on these initiatives is generally independent of macroeconomic conditions, and we're focused on continuing to invest and grow in this market.

Our emerging markets, including mining, water resources and energy services, grew by 5%, year over year, in the first quarter. This increase was led by growth in renewable energy revenue followed by mining and water resources.

In the renewables market, we're providing a wide array of engineering services to solar and battery storage projects throughout the Northeast and Mid-Atlantic, and a growing number of wind energy projects in the Midwest and the West. Growth in renewables-related revenue has so far been organic, but we expect to accelerate that effort through acquisition later in 2022 and beyond.

Acquisition integration continues to be a huge focus for us. Our dedicated integration team is doing a great job with both the tactical and the social aspects of integration. Including McMahon, we've added over 400 employees through acquisition in our first year as a public company, and the staff retention rate of our integrated companies thus far has been close to 97%.

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Above and beyond the talent we've gained from the acquisitions, our dedicated recruiting team has been able to add nearly 10% to the acquired firm's workforces. Just as important, our integration team immediately gets everybody focused on revenue synergies, and we've already notched up a number of successes along those lines.

Between the revenue synergies and improved utilisation resulting from our recruiting successes, we're benefiting from substantial post-closing effective compression of our transaction multiples.

Our M&A pipeline continues to be as diverse and robust as it's ever been, and our outlook for continued strategic transaction activity remains bullish. At 28 million in annualised revenue, McMahon is well above what we expect to be our average deal size in 2022.

As we've said, we expect the average to be significantly larger than last year. We're currently shopping many deals in the low-double-digit revenue range. We continue to be focusing on deals in the six to seven times multiple range with occasional deals above and below that.

McMahon, as an example, was priced at a multiple of 6.5 times adjusted EBITDA, without any consideration given to revenue synergies. We're not directly affected by supply chain disruptions, and labour is our only real inflationary exposure. The overwhelming majority of our clients are, likewise, not directly affected by material supply constraints, and their demand for our services is only increasing.

Across our markets, demand for engineering and design services remains strong as evidenced by growth in revenue and [unclear]. Pricing power remains in our favour, as evidenced by year-over-year revenue growth meaningfully outpacing our growth and labour costs.

Despite certain headwinds in the equity markets, we remain bullish in our prospects for continued growth and upside in our value proposition to our shareholders. We're raising our outlook for 2022 today, and as new acquisitions close, we'll continue to increase our outlook accordingly. Now I'm going to turn the call over to Bruce to discuss our first quarter results in greater detail.

Bruce Labovitz Terrific, thanks, Gary. As you mentioned, Gary mentioned, the first quarter was a record-setting quarter at Bowman. Last week was the one-year anniversary of the pricing of our IPO. I'm extremely proud to say that we've successfully navigated the transition from private to public, and completed the year of firsts. Last year Q1, we were still a private company, so comparisons to that quarter and periods which include that quarter are still a bit apples to oranges.

As compared to Q1 2021, gross revenue for the first quarter increased 65%, or \$20.7 million, to \$52.5 million from \$31.8 million. Of the nearly \$21 million increase, \$7.6 million was from acquired revenue and \$13 million was organic, representing a 41% organic growth rate on gross revenue.

Net service revenue, which we refer to as net revenue, a non-GAAP metric, increased 65.2%, or 18.8 million, to 47.7 million in the first quarter, compared to 28.9 million for the first quarter last year.

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Of the nearly \$19 million increase in net revenue, 8.6 million was from acquisition, and the remaining 10 million was organic representing a nearly 36% organic growth rate, year over year. Gross margin for the first quarter was 51.5%, as compared to 49.2% in Q1 2021.

Improvement of gross margin over Q1 last year is principally a function of lower non-cash stock comp expense, but also improved utilisation, mix of business, and a bit of pricing power.

SG&A was 43.5% of gross revenue in the first quarter, compared to 40.1% for Q1 2021. As I mentioned earlier, this comparison is not necessarily meaningful, since this time last year we were still private and did not have any of the costs of being public, and we had lower non-cash stock comp expenses.

What is notable is that SG&A as a percentage of gross revenue is trending down relative to Q4 last year, and last year as a whole. We continue to be focused on reducing the rate of growth of SG&A relative to revenue. Expect SG&A to fall as a percentage of gross revenue as we continue to build scale.

Net income before tax was relatively flat year over year, with net profit for the first quarter up 50% to 1.5 million. Adjusted EBITDA for the first quarter was up 81%, to \$7.4 million, representing a 15.5% adjusted EBITDA margin net. This is an increase of 1.3 percentage points over Q1 2021, and 3.3 percentage points over full year 2021. Adjusted EBITDA is a non-GAAP metric, which adds non-reoccurring adjustments and non-cash expenses to EBITDA.

As of March 31st, the company had approximately 12.6 million shares outstanding, which includes all the shares issued in the secondary offering and roughly 2.1 million shares of unvested restricted stock included in that number.

As of today, the company has approximately 13.2 million shares outstanding, which includes shares issued in connection with the McMahon acquisition, and now roughly 2 million shares of unvested restricted stock included.

As of March 31st, our net debt was negative to the tune of roughly 7 million. Unadjusted for cash, our ratio of adjusted EBITDA to total debt was approximately 1.4 times.

We currently have approximately 23 million of cash on our balance sheet and zero outstanding on our \$17 million line with BofA, which was recently approved to be increased to 25. That leaves us with upwards of \$35 million of deployable capital for growth, after accounting for working capital needs. As such, we believe we have sufficient liquidity for the near term to continue our M&A programme.

Gross backlog on March 31st was \$173 million, up from 167 million at year-end. We expect roughly 85%, or 150 million, of that backlog to turn during the next 12 months. Backlog was approximately 65% building infrastructure, 18% transportation, 15% power and utilities, and 2% the other emerging markets.

Pro forma for the addition of McMahon effective January 1st, transportation would have represented roughly 29% of our backlog. Building infrastructure would have been roughly 56%.

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As indicated in yesterday's release, we're increasing our outline for top-line guidance to net revenue of 185 million to 200 million, and increasing our adjusted EBITDA guidance to 25 million to 29 million. This adds the impact of McMahon to top and bottom line with little or no change to the outlook we issued just a few weeks ago, back in mid-March.

As is our policy, this guidance only includes acquisitions closed at the time we issue the guidance. It does not suggest the results will be evenly distributed throughout the year and it, likewise, does not contemplate additional acquisitions we expect to close this year. As new acquisitions are closed, we will update our guidance accordingly on the subsequent quarterly conference calls.

Before I turn back the call over to Gary, I'd like to mention that we will be at the B. Riley Securities International Investor Conference later this month in California. If you're planning to attend the conference and you've not already done so, please schedule a time to meet with us, one-on-one. I'll now turn the call back over to Gary for concluding remarks and Q&A.

Gary Bowman Thanks, Bruce. This morning, we announced the addition of Raymond Vicks to our board of directors. I'm very happy to have Ray joining us on our upcoming journey. I want to thank Dan Lefavre for his service to the board over the past year. I want to thank everybody here for delivering a fantastic quarter.

We all continue to work diligently every day to deliver disciplined growth and return to our shareholders, and that includes many of the fantastic professionals working here at Bowman. Ownership's always been part of our culture and today, more than ever, the alignment of interest between the employees and investors inspires us to succeed. Thanks, I will now turn it back over to the operator, to open it up for questions.

Operator Thank you. At this time, I would like to remind everyone in order to ask a question, press start, then a number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. Our first question comes from the line of Brent Thielman of DA Davidson. Your line is now open.

Brent Thielman Great, thanks, good morning, Gary, Bruce. My first question, really strong start to the year here, anything to be aware of that might have had an unusually strong impact this quarter, specific programmes or contracts? It's a seasonally slower quarter, if I annualise that, that gets me to the midpoint of your guidance, frankly, a little bit above that, so I just want to be sure I understand all the moving pieces in the quarter, and what we should be thinking about for the rest of the year.

Bruce Labovitz Brent, there really isn't one particular contractor, one particular client or any one particular event that made the quarter strong. It was just a strong quarter for us. It's the culmination of a lot of hard work in business development and acquisition strategy.

And there's a really a very balanced portfolio of revenue that makes up the quarter, so we think that's a positive, that there isn't one anomalous thing that impacted it positively.

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Gary Bowman I'll just reinforce that, Brent, it is spread all over. There's not any big rock, a couple big rocks, that are not sustainable that goosed it.

Bruce Labovitz Yes, we were not terribly seasonally weather-affected generally. It was a mild, more mild, winter in a lot of our markets and we have become, as we become more geographically diversified, somewhat less impacted by winter weather on outdoor work.

Brent Thielman Okay, fair enough. And then the next question was just the gross margins seem to be fine, new contracts, how do you feel they're appropriately capturing the cost increases we all see out there, fuel, labour, all that sort of stuff we've seen the business? And then, how are you monitoring that, as new workflows into the backlog?

Gary Bowman Brent, I anticipated that, thinking about it this morning. We have really probably hundreds of pricing agents out there, seller-doers, and we counsel them, we coach them, and we listen through them, and our customers are experiencing price increases all across the board, in their materials, their fuel, their labour, and we're coaching our folks because we're having a lot of pressure to increase our labour, the price of our labour is going up, and they're not meeting resistance to increase pricing. Our customers are expecting it.

So our folks are receptive to the coaching and they're out there, and we were able to get our pricing up coincident with what's happening in the marketplace. This inflationary environment's new to everybody. Another thing, Brent, just to point out, fuel in particular, since you mentioned that, is not a significantly large component of our costs on a regular basis.

We have a fleet of vehicles that are out, that they do survey work, but the vast majority of the work that we produce and the revenue that comes out of here is done from inside an office, and isn't necessarily, from our cost point of view, fuel-driven. Our expense is labour.

Brent Thielman Yes, okay, fair enough. And then, Gary, why McMahon Associates? Why was that the right kind of large transaction to expand the transportation footprint for you? What did you especially like about this business?

Gary Bowman Great question. It's a little bit it was geographically correct. It was more than bite-sized, but it was a comfortable size for us. It was the appropriate stretch. We really liked the culture, similar to our culture, it's a strong ownership culture, lots of stockholders that have been there a long time, and it's a very receptive leadership to taking the next step along with us and growing with us, and certainly congruent with our strategy of growing our transportation practice really.

And they have some great clients, Tendot Transportation Turnpike Authority, Massachusetts Turnpike Authority, they do work for Florida DoT, which we do but they're on the design side, so some really complementary clients. So just lots of factors made them a great fit for us, our first really big increase in a diverse market.

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Bruce Labovitz Also, as we started to do due diligence, the way they've grown the organisation, as they've grown the size of the business, was very professional. The products of information that they were able to provide to us was quick, accurate, organised. And so, they had built, in a lot of ways, the way we had built as we grew through their size, and so it was very easy to understand them. And compliments to the folks who do all of their back-office work there. We saw that it would be easy to plug in.

Gary Bowman And it was kind of manna from heaven, but it was really confirmed, literally within the first few days, this one deal from one of our longstanding clients immediately, hey, we closed this seven-figure traffic study deal because we had McMahon. It's like, wow, that's what it's all about.

Brent Thielman That's great. Maybe just the last one and I'll turn it over. Considering this is a larger deal, I assume there's a little more integration to it, but you obviously have some bigger targets for what you'd like to do, I think, this year in terms of acquired revenue. Do you take a step back here on the short term and focus on integration? Maybe just how we might think about the deal flow here through the rest of the year.

Gary Bowman They're going to continue to come. We've we have built a very robust integration team, dedicated integration team, and so we've, we've got strong integration bandwidth.

And in fact, yes, we've got a lot of listing to do to integrate McMahon, it's going to be a long haul to integrate McMahon, but the deals will keep on coming, and we've got the bandwidth, we've got the team, we've got the machine built to continue to integrate and bring them into the team here. McMahon is not going to slow us down.

Brent Thielman Understood, okay, thanks, Gary. Thanks, Bruce.

Gary Bowman Thanks, Brent.

Operator Thank you. Your next question comes from the line of Alex Rygiel of B. Riley Financial. Your line is now open.

Alex Rygiel Thank you, good morning, gentlemen. A nice quarter and nice acquisition.

Gary Bowman Thanks, Alex.

Alex Rygiel A couple of quick questions. You've talked in the past about some other end markets, such as power, infrastructure, mining, water, and renewables, can you talk about the activity in the quarter there, and the pipeline of work that you see on the horizon?

Bruce Labovitz Yes. Those are still the smaller parts of our business. We definitely saw good growth in renewables over the course of the quarter, a little bit of a decline in water resources and strong activity in mining, but again, as a collective, they represent less than 5% of revenue today.

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I think that they are, knowing our pipeline, a focus of M&A activity. I don't think anything necessarily, in the short term, of the size that would move them into a competing percentage as the three other primaries. But I'll let Gary [unclear].

Gary Bowman I'll expand a little bit of what Bruce is saying. Renewables is a focus, although we've not had any hits on acquisitions, but it is a focus, and we've really had some super-successes, candidly, under my radar, that just my radar started lighting up, organic growth of successes and renewables. So organically we're really growing our renewables practice. We're going to continue to focus on growing by acquisition, so we can really continue our commitment to growing that.

And on the mining front, we're looking at several relatively smaller but meaningful acquisitions, and our paradigm is expanding on that. We've been in the mining business some ten years, in Arizona is copper mining, and our paradigm is expanding to include, I'll say, mining/quarrying with aggregates to be expanded to an infrastructure play, to serve the highway and infrastructure market. That market is on fire with the infrastructure bill.

Alex Rygiel And then more broadly speaking, can you talk about inflation risk and, in particular, obviously labour inflation, and how quickly you can react to that and pass that along to be able to keep your margin profiles fairly consistent?

Gary Bowman Yes, it's a great question, Alex. And like I told Brent this morning, I was anticipating that this morning, and so far, so good. And the way I look at that is I started my professional career when Paul Volcker was chairman of the fed, so none of us who are in the professional world today really have experienced inflation as professionals. So, we all kind of feel our way through it.

I said this a little bit before, so far we are finding that our clients are expecting price increases from us. They're getting hit from all sides, so they are not that resistant to it. And it's new for our folks to push that. Like I say, we're coaching them to do it. They're going out and they're being appropriately aggressive about pushing the pricing.

They're learning that the market is receptive to it. So, it's kind of new to everybody. So we are finding that we are able to increase our pricing to be able to keep up with our demands to increase the cost of labour. So it's so far so good. Like I said, we continue to feel our way through it. We are optimistic and confident we're going to be able to continue to navigate through it.

Bruce Labovitz And we don't have any meaningful contracts that are old enough that we're out of the money on labour. We're not locked in, we don't have these kinds of contracts that five years ago we set rates and had no escalators in them. Part of the benefit of the term of our business right now is that we are in a somewhat real-time pricing environment for a lot of the work that we do.

Alex Rygiel And then, Bruce, can you talk about rising interest rates and how you think about that as it relates to your capital structure, moving forward?

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Bruce Labovitz As it stands today, we're fairly low leverage. Interest rates aren't necessarily consuming a lot of changing rates. Interest carries are not consuming a lot of capital here. We think that the next, in our near future, as we grow, debt will be a component of what we do, but we're not necessarily looking to lock in a large amount of capital today that we have to carry for a period when we don't really necessarily need it imminently.

So, I think rate movements, long term, are just going to be a cost of playing for us. We'll deal with rates when we get to when we need more capital. But I don't think we're going to be so highly leveraged ever that it's a huge negative drag on the capital structure here. Does that address what you're looking for?

Alex Rygiel It sure does, great answer. Thank you very much.

Bruce Labovitz Alright, thanks, Alex.

Gary Bowman Thanks, Alex.

Operator Thank you. We now have a follow up from Brent Thielman of DA Davidson. Your line is now open.

Brent Thielman Thanks, guys. Just one more on the cash flow. It was particularly solid this quarter, maybe just your thoughts on how that flows, Bruce, through the rest of the year?

Bruce Labovitz Yes, I think we're reaching a stride, there. Again, our operating cash flow, we believe, is going to be strong. We still consume cash for investment activity and probably won't be generating necessarily. We've done the financing activity earlier this year, but certainly one of the things that we see over time, here, the impact of the growth is that it generates cash.

And so sort of back to Alex's question of how do we see interest rates affecting the business, we're looking for the growth to start generating more free cash flow that can be used for investment in additional growth, but I think we had solid trajectory this quarter for cash flow, and expect that we can turn our adjusted EBITDA into cash at a pretty healthy rate, going forward.

Brent Thielman Okay, great, thank you.

Bruce Labovitz Thank you.

Operator Thank you. There are no further questions at this time. Mr Bowman, I turn the conference call back over to you.

Gary Bowman Thank you, Candice. We'll wrap it up this morning. Thank you, everybody, for listening in. And thanks, Brent and Alex, for thoughtful questions, and appreciate everybody being on the call, and thanks to all the Bowman employees for all the hard work, and all the investors for the faith you put in us. And it's not misplaced, we work hard to build value here. Good morning, everyone. Thanks, operator, that's it.