Orion Group Holdings(Q3 2023 Earnings)

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Corporate Speakers:

- Margaret Boyce; Orion Group Holdings; Investor Relations
- Travis Boone; Orion Group Holdings; President & CEO
- Scott Thanisch; Orion Group Holdings; Executive Vice President & CFO

Participants:

- Joe Gomes; Noble Capital; Analyst
- Julio Romero; Sidoti & Company; Analyst
- Dave Storms; Stonegate Capital Markets; Analyst
- Alex Rygiel; B. Riley Securities; Analyst

PRESENTATION

Operator^ Thank you for standing by. And welcome to the Q3 2023 Orion Group Holdings, Inc. Earnings Conference Call.

I would now like to welcome Margaret Boyce, Investor Relations for Orion, to begin the call.

Margaret, over to you.

Margaret Boyce^ Thank you all for joining us today to discuss Orion Group Holdings' third quarter 2023 financial results.

We issued our earnings release after market last night. It is available in the Investor Relations section of our website at oriongroupholdingsinc.com.

I'm here today with Travis Boone, Chief Executive Officer of Orion; and Scott Thanisch, Chief Financial Officer.

On today's call management will provide prepared remarks, and then we'll open up the call for your questions.

Before we begin, I would like to remind you that today's comments will include forward-looking statements under the federal securities laws.

Forward-looking statements are identified by words such as will, be, intend, believe, expect, anticipate or other comparable words and phrases. Statements that are not historical facts are forward-looking statements.

Our actual financial condition and results of operations may vary materially from those contemplated by such forward-looking statements.

Discussion of the factors that could cause our results to differ materially from these forward-looking statements are contained in our SEC filings, including our reports on Form 10-Q and 10-K. I'd also like to let you know that Orion will be presenting at the Noble Capital Market, NobleCon19 conference, December 3rd through 5th in Boca Raton, Florida.

With that, I'd now like to turn the call over to Travis.

Travis, please go ahead.

Travis Boone^ Thank you, Margaret. And welcome everyone to our third quarter 2023 conference call.

On September 12, Scott and I celebrated our first anniversary with Orion and looking back, it's been a very exciting and productive year. Both Scott and I are proud of what our team has accomplished. When we assumed our leadership roles, we knew that success would rely on our people embracing change and pulling together to transform our business performance. They stepped up to the plate, eager to move Orion into a new era of collaboration and opportunity. We are now beginning to reap the benefits of the changes we put into place, and we continue to feel bullish about what we can achieve in the future.

Last quarter, we told you that we expected continued improvement in profitability through the back half of the year, and we are delivering on that promise. Our third quarter revenue came in around $169 million, and our adjusted net income for diluted share was $0.02. Third quarter adjusted EBITDA was $9.4 million versus $3.7 million in Q2. While revenue is down somewhat year-over-year due to our exit from Central Texas, the higher quality of our revenue is delivering improved profitability.

Since March, our Concrete business has been profitable and improving on an adjusted EBITDA basis, and it is operating income positive on an unconsolidated basis in the third quarter. We have recent wins totaling $50.8 million in Concrete and they are the type of projects that require our expertise and will deliver strong margins. Bid activity has remained steady in our core markets of Dallas and Houston. As I mentioned last quarter, the cost of capital is still a restraining factor in converting bids to backlog, but demand is strong and we are staying focused and disciplined pursuing projects aligned with our capabilities where we are positioned to win.

Turning to our Marine business, we've got a lot of momentum with projects won and potential future projects. As we reported in October, we were awarded a significant design-build contract for Grand Bahamas Shipyard Dry Dock for $120 million. This is an exciting project for several reasons. The pursuit required multiple skill competencies and our Marine and Engineering teams demonstrated the power of collaboration in scoping out a very complex project that includes infrastructure construction, dredging, creating new mooring facilities, and providing enhancements to shore stability.

Our team is especially excited about being part of what will be a historic project in the Caribbean. When completed, the Grand Bahama project will have the largest floating dry docks in the Western Hemisphere capable of lifting the largest cruise ships in the world. These state-of-the-art floating dry docks promise substantial efficiency and cost savings for the shipyard's customers, and this venture also reflects the Bahamian spirit of their country's motto, “Forward, Upward, Onward, Together.” This project is set to commence immediately and be completed in 2025.

The Bahamian project is just one example of the opportunities we see for Marine. For a quick recap:

- It is estimated that $50 billion will be spent for coastal restoration in Louisiana alone in the coming years and we are focused on capturing that work.

- The Panama Canal expansion created the need for U.S. port expansion projects from Texas all the way up to the East Coast to accommodate larger ships in both public and private facilities. The infrastructure bill will fund important projects in our areas of operation and well within our core capabilities in marine construction.

- For a quick update on Hawaii, our team is mobilized. We have people and equipment on the ground and work is starting in earnest in the fourth quarter. Pearl Harbor is clearly a game changer for Orion. Naval defense spending in the Pacific in the coming years is projected to be tens of billions of dollars, and it's an urgent priority for our government. Our work with the Navy at Pearl Harbor strategically positions us to leverage this opportunity. I think we'll look back on this project as the tipping point that accelerated the next phase of Orion's growth.

- We get a lot of questions about Army Corps of Engineers dredging contracts. The near-term issue is that dribbling out these projects has created intense competition among smaller players who need to get equipment utilized after a dry spell of activity. We've won a few dredging bids, but we will be careful not to fall into the trap of winning work at margins that are too low. There's pent-up demand that we think will be a tailwind for us well into 2024 and ‘25.

A key health indicator of the business is backlog, and we've doubled it since last year. At quarter end, our backlog was $878 million. Altogether, our backlog and contracts award subsequent to September 30th, totaled $920 million.

Overall, there are three significant areas to drive the business forward. First, good margins will be a key driver of our success. That includes winning more work with attractive pricing on better projects and then delivering that work with predictable excellence. Second, investment in business development to build customer relationships and identify opportunities further in advance. Lastly, investing in our people and equipment to maximize our ability to capture the abundant opportunities in our markets.

Our framework is in place, and some of the changes will take time to fully implement. Culture doesn't change overnight, but we've made great progress. Upgrading IT systems is ongoing, and full implementation will not be complete until next year.

Before I turn the call over to Scott, I want to share a moment of personal pride in our team. Last month, Orion was recognized for outstanding safety leadership by the Council of Dredging and Marine Construction Safety, and we were nominated for this award by our industry peers. I was honored to accept the award on behalf of our Orion team, who worked collaboratively every day to meet the exacting standards, while safely delivering world-class marine construction and dredging services to our customers.

Our safety through leadership success is born out of a strong advocacy for accident prevention, innovative training, and a commitment to exceeding regulatory compliance. Being responsible and accountable is a priority for every team member, with a special emphasis on performing every task safely, every time.

Thank you, and I'll turn the call over to Scott.

Scott Thanisch^ Thanks, Travis. I'll cover some highlights and then review the third quarter results. As Travis pointed out, there's a lot of opportunity ahead for Orion, and maintaining a strong balance sheet and liquidity is a top priority in executing our growth strategy. Financial strength is extremely important in winning large contracts that can span over multiple years.

As I reported last quarter, we increased our access to capital with our lenders and succeeded in monetizing $25 million in sale-leaseback transactions, including the $12 million sale of our Port Lavaca South Yard. We remain focused on monetizing our real estate assets such as our East-West Jones property. East-West Jones is a unique development opportunity with 345 acres on the Houston Shipping Channel and has generated interest from multiple parties. We had previously announced a signed contract on this land, but that buyer ran into financing issues. We're now negotiating with another buyer and we're confident that we will complete a transaction that will provide additional capital to invest and grow our business in 2024.

As a result of our performance and Orion's improved financial position, we've also been able to significantly increase our bonding capacity. This gives us greater ability to bid and win larger projects and grow our business above where we are today.

To wrap up on the balance sheet, as of September 30th, we had $3.9 million cash and total debt outstanding of $50.3 million. Our debt is higher than the end of the second quarter due to a temporary investment in working capital with a mobilization underway in Hawaii.

Moving on to our financial results. Orion produced $168.5 million of revenue in the third quarter, down 8% sequentially and 8% from the prior year. The revenue decline was largely driven due to our exit from the Central Texas construction market, partially offset by increased revenue in our Marine segment from the Hawaii dry dock project.

Third quarter gross profit was $19.1 million, or 11.3% of revenue, compared to $13.4 million, or 7.4% of revenue last year. The gross margin increase of 390 basis points primarily reflected the actions we've taken to improve Concrete segment margins, partially offset by lower equipment and labor utilization in our dredging business.

SG&A expenses for the third quarter were $17.1 million, or 10.2% of revenues, compared to $15.4 million, or 8.5% of revenues in the prior year period. SG&A grew due to increased business development and IT costs, as well as higher legal expenses related to customer claims.

Adjusted net income for the quarter was $800,000, or an adjusted net income of $0.02 per diluted share, which was the same as what we achieved in the prior year period. This result excludes $1.5 million or $0.04 diluted earnings per share of non-recurring items. Our gap net loss for the third quarter 2023 was $700,000, or $0.02 loss per diluted share. EBITDA for the third quarter was $8.7 million, and adjusted EBITDA was $9.4 million. Adjusted EBITDA margin was 5.6%, up from 4.8% in the prior year period.

Turning to bidding metrics, in the third quarter we bid on approximately $1.1 billion worth of opportunities and won $227 million. This resulted in a contract-value weighted win rate of 21% and a book-to-bill ratio of 1.35x for the quarter. As of September 30th, our backlog was $877.5 million, a 60% increase over the $548.6 million backlog on September 30th of 2022. Breaking out our third quarter backlog, $700 million of this was related to our Marine segment and $178 million was related to our Concrete segment.

Furthermore, we've been awarded over $43 million for new project work, not included in our backlog at the end of the third quarter. Of this, approximately $22 million is related to Marine, while $21 million is related to the Concrete segment.

Overall, we are pleased with the progress our team is making to improve our margins by winning quality work at attractive pricing. We think low double-digit adjusted EBITDA margins are achievable for Marine. Our Marine segment is performing well and in the third quarter adjusted EBITDA margin was 9%. We are experiencing some near-term impact due to lower mix and margin from our dredging business.

Our concrete segment produced adjusted EBITDA margin of 2.4% in the quarter compared to negative margins in the prior year. We continue to believe that our Concrete business can achieve high single-digit adjusted EBITDA margins and we expect continued expansion of these margins towards our goals over the coming quarters. As we look ahead to the fourth quarter and beyond, we are very optimistic. We've won several attractive and prestigious projects, we're executing well, we have sufficient capacity to grow and we are optimizing our people and assets to take advantage of the significant opportunities in our markets.

As with any project-based business, there will be variability in quarter-to-quarter results depending on when projects start and roll off, but the general upward trend in our top and bottom lines will continue. Our backlog is growing and so is our reputation for being a significant player in our targeted markets. Going forward, we'll see operating leverage as we continue to grow the top-line. Margin execution improvement will continue to bear fruit. There's been a lot of positive momentum in our business and that should flow through Q4 and into Q1 of 2024.

With that, we'll open the call to your questions.

Operator?

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions). Our first question comes from the line of Joe Gomes from Noble Capital. Please go ahead.

Joe Gomes^ Good morning. Thanks for taking my questions.

Travis Boone^ Good morning, Joe.

Scott Thanisch^ Good morning, Joe.

Joe Gomes^ So I wanted to start just on the top-line, on the revenue. Came a little bit lighter than we were expecting, than I think consensus was expecting. Was wondering was top-line revenue in line with what you guys thought; prior to the quarter was a little softer than what you were thinking and how does that look? You just mentioned, Scott, the general upward trend should continue. But I think consensus for the fourth quarter is more around that $200 million level. Are we all being a little too optimistic there for the fourth quarter, even with some of these new contracts coming online?

Scott Thanisch^ No. I don't think the fourth quarter is optimistic from the perspective of what I've seen out there with those expectations. But we're pleased with where the quarter ended up. We have a growing backlog. And so, although the revenue timing may vary a bit from quarter-to-quarter, with the backlog growing the revenue will come. And so the margin is -- the margin performance was pretty significant this quarter and we're happy to see that continue. So I think that for the full-year, we're kind of in line with what we were originally thinking it would look like, and going into next year, we expect to have some good momentum.

Joe Gomes^ Okay. Thanks for that. And then you talked a little bit about the bidding environment. Just maybe getting your guys' thoughts. Obviously, what's happening in Washington, the continuing resolution. Are you seeing any impact on the bidding environment from that, or do you think that, given some of the past bills that have been passed for spending in the area, especially on the marine side, that the continuing resolution shouldn't have much of an impact on you guys, assuming it doesn't just drag out forever?

Travis Boone^ Yes. We're not seeing any impacts yet, Joe. It's been fairly kind of consistent, and we haven't seen the bid opportunities slowing down because of continuing resolution yet, it’s to be seen what happens next year, in case if something does shift there. But I think things are continuing to move.

Scott Thanisch^ And I think that there's generally good support on both sides of the aisle for the projects that we would benefit from.

So Washington has its issues. But I think everyone agrees that the country needs investment in infrastructure, particularly in the marine space.

Joe Gomes^ Great, thanks for taking the question. I will get back in queue.

Operator^ Our next question comes from the line of Julio Romero from Sidoti. Please go ahead.

Julio Romero^ Hi. So I appreciate the color you gave about the current bidding environment for dredging. Maybe what's your sense about when the competitive environment might abate?

Maybe you can point to historical instances when something like this has happened. And when do you think the environment will allow you to bid for projects with more proper bid margins that you're targeting?

Travis Boone^ We think it's going to be sometime probably late next year. It's probably going to continue somewhat like this for some period of time. Obviously, we'd like for it to be sooner, but it seems like it's going to continue this way for a little while longer.

Scott Thanisch^ Yes. So we're just making ourselves look at our schedules, be mindful of our maintenance cycles, being disciplined in the bidding processes that we're engaged in and making sure that we value our contributions appropriately and we're pricing ourselves right.

We're not going to lock our equipment up on low margin work for long periods of time. But we'll price ourselves according to market dynamics and kind of ride out the storm. We're larger than some of these small players that have to act more desperately.

Julio Romero^ Got it. That's very helpful. And then maybe piggybacking on Joe's question a little bit about the top-line, maybe specifically on the marine side. Because the marine sales sequentially contracted a bit. Is it fair that they're expected to increase back upward next quarter towards maybe second quarter's top-line figure or is that not in the ballpark?

Scott Thanisch^ Yes, we should see a continuing growth in the marine revenue line as we have more and more production coming off of Hawaii that will really start to produce in the fourth quarter. Just early starts on that the Grand Shipyard in Grand Bahamas. That's also going to start contributing. So the top-line in the marine is going to come up pretty significantly starting in the next quarter and then really in earnest starting into the first and second quarter of next year.

Julio Romero^ Really appreciate the color there. I'll hop back into queue. Thanks very much.

Scott Thanisch^ Thanks, Julio.

Operator^ Our next question comes from the line of Dave Storms from Stonegate Capital Markets. Please go ahead.

Dave Storms^ Good morning.

Travis Boone^ Good morning, Dave.

Dave Storms^ I appreciate you taking my call. Just wanted to start with the East West Jones property. If I remember correctly, that had a price tag of about $36 million. Will that or has that been repriced and is there an expected close date with the new potential buyer?

Travis Boone^ Yes, so we're still marketing in that same neighborhood and we anticipate the conversations that we're engaged in right now will continue and conclude successfully– the timing of a transaction would be early next year.

Dave Storms^ Very helpful. Thank you. And then just one more for me with the great contract win in the Grand Bahamas. Are there any logistical challenges or resource constraints that you're foreseeing considering you're going to have two very large projects on either side of the continent?

Travis Boone^ No, it's not really an issue for us. We've got multiple crews and multiple teams and it's different resources both with our equipment and people that will be delivering each project. So no concerns as far as resource constraints internally. It's a different country. So there's challenges with different things getting going in a different country. But it's moving quickly and we're mobilizing and getting started on the Bahama project.

Dave Storms^ That's very helpful. Thank you.

Operator^ Our next question comes from the line of Alex Rygiel from B. Riley. Please go ahead.

Alex Rygiel^ Thank you, gentlemen. Coming back to the Grand Bahama project. What's the margin profile of that project relative to some others and any notable working capital needs in the short-term?

Travis Boone^ Yes, we don't talk about specific project margins, but that's a project that we're really happy with both in terms of it fitting our strategic direction being a design build contract, bringing more of our services to bear for our customers. And also just being in a different geographic space than in Hawaii where we've also got some growth going on. It's nice to kind of balance out that. So I'm happy with the margin profile and expect to see continued improvement in the overall marine margins as we execute on that and the Hawaiian project going forward.

Alex Rygiel^ And then any working capital needs in short-term on that?

Travis Boone^ There's a fairly good dynamic within that contract for mobilization payments. So the working capital investment is relatively small. Obviously working in some different currencies will drive a little bit extra need than what we might normally have. But relatively modest, so not a significant build in working capital anticipated related to Grand Bahamas.

Alex Rygiel^ And then as it relates to fourth quarter directionally, how should we think about SG&A expense? I know last year turned down sequentially quite a bit, but given the increase in work here, how should we think about SG&A in the fourth quarter relative to the third?

Travis Boone^ Yes, I think that we'll see kind of continued levels around where we are, potentially a little growth in those legal expenses that I mentioned as we have some customer claims that we're pursuing. And that's probably going to be a higher need over the near-term as we have a couple of fairly significant customer claims that we'll be investing legal expense in. But I would think the third quarter would be a good measuring stick for where it's expected to be in the fourth quarter and beyond.

Alex Rygiel^ And was there any positive benefit from when East West broke apart?

Scott Thanisch^ Relatively minor. I mean, there was some earnest money that was forfeited, but not a material amount.

Alex Rygiel^ Great. Thank you very much.

Scott Thanisch^ Thanks.

Operator^ (Operator Instructions) There are no further questions at this time.

I would now like to turn the call over to Travis Boone for closing remarks.

Travis Boone^ Thanks, Mundy. We are proud of the progress we have made with transforming this business to be healthier, profitable, and set up for future success. We have been doing what we said we would do, and the results are starting to show. Our team has been working hard to make it all happen, and we appreciate all of their efforts to make us a stronger company. Finally, our thoughts and prayers are with those who are facing the adversities of war.

While being a U.S. domestic company may provide some insulation, we can only keep praying for a peaceful resolution to these devastating conflicts. Thank you for participating today, and as always, we welcome the opportunity to maintain an open line of communication with current and potential investors.

Operator^ I would like to thank our speakers for today's presentation and thank you all for joining us. This now concludes today's call. You may now disconnect.