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Q3 2018 Hill International Inc Earnings Call

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John Glenn Grau

PRESENTATION

Operator

Welcome to Hill International's Third Quarter Earnings for Fiscal Year 2018 Investor Call.

On this call, John Grau of InvestorCom will provide some introductory remarks on the content of the call. John will be followed by Hill International's CEO, Raouf Ghali; and Interim Vice President and Interim Chief Financial Officer, Greg Wolf.

Mr. Ghali will discuss the status of the company and expectations for Hill's immediate and long-term future. Mr. Wolf will deal with Hill's third quarter earnings for 2018. This will be followed by an opportunity for questions and answers from our shareholders, and then we will end the call. As a reminder, this call is being recorded.

John, please begin.

John Glenn Grau

Thank you. To everyone on this call, please note the following: certain statements made on this call are considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, and it is our intent that such statements be protected by the safe harbor created thereby. Except for historical information and matters set forth herein, including any statements of belief or intent and any statements concerning our future plans and strategies are forward-looking statements. These forward-looking statements are based on our current expectations and assumptions and are subject to risks and uncertainties. We do not intend and undertake no obligation to update any forward-looking statement.

With that, let me turn the call over to Raouf Ghali, Hill International's CEO.

Raouf S. Ghali ***Hill International, Inc. - CEO & Director***

Thank you, John, and thanks to everyone on the call for joining us this morning. Before we begin the discussion of our third quarter performance, I want to express that Hill International is entering an exciting new phase of growth and profitability. 2018 is a transition year. I'm confident our company is a much improved -- in a much improved position and ready to realize the opportunities before us today and into 2019 and beyond.

Although revenue was lower in the third quarter and year-to-date compared to 2017, our adjusted EBITDA continues to improve period-over-period, as a result of our profit improvement plan. We are in the process of expanding our sales force to capture more opportunities throughout the world, and I'm very excited about our real focus and growth and profitability.

In my 25 years with Hill, I've seen the company grow from a 250 employee niche firm to an industry leader with more than 2,800 employees, operating across 5 continents. Our success, then and now, is directly attributed to the quality of personnel. Hill's profitability is driven by the value-added service we consistently deliver to our clients. This formula has not changed.

Going forward, we will drive growth and profitability by winning new business, delivering the projects our client envision and attracting the best talent from around the world.

After having addressed the challenges of the past 18 months, we are ready to focus on reemploying our formula for success. We will do this from a solid financial position.

We are current with all our SEC filings, and we have rightsized our organization. We've eliminated costs that were incurred with the development and execution of our profit improvement plan and bringing Hill current with its SEC filings.

And installed formal cost-control measures and policies company-wide to ensure health continues its culture of corporate accountability. These steps presented obstacles to the organization, but we do expect to see improvements in our financial position in both the short and long term.

Despite the challenges of last 18 months, Hill remains a trusted partner to our clients, and continue to win and execute major assignments in all markets where we operate.

In the third quarter, our backlog has increased by $3 million to approximately $820 million over the second quarter 2018.

We continue to bid on exciting, viable and profitable opportunities. Many of these opportunities involve the type of large complex multiyear megaprojects, where Hill has traditionally excelled. As a reminder, our backlog is Consulting Fee Revenue, or CFR, which makes up the majority of our total revenue on our financial statements.

We are also planning to expand and promote several of our existing services where we have identified opportunities to realize profitable growth. These services are preconstruction support, advisory services and post-construction facility management. Delivering these services will further integrate Hill into our clients' projects and programs and do so without impacting our risk profile.

All these moves are generating an atmosphere of excitement at Hill. I have visited numerous Hill offices and spoken with our employees in many of our regions, and all are ready to renew our emphasis on growth and deliver the quality of services our clients expect and drive greater returns for our shareholders.

I am, of course, equally enthusiastic about Hill's prospects, and look forward to providing updates on the progress of our growth in future announcements and calls.

For today, I would like to share our expectations for 2018 revenues and mention some of the company's most recent project wins.

For 2018, we continue to expect total revenue to be in the range of $420 million to $430 million, consistent with our last update of October '18 -- 2018. Our current quarterly run rate of approximately $100 million total revenue has leveled off, and we believe that future quarters will begin to see growth.

Among our excitement, new projects. Hill was awarded a contract from the Pennsylvania Turnpike Commission to support the $900 million expansion of the Mon/Fayette Expressway System, where Hill will be providing construction management and related support.

In Latin America, Hill was recently awarded 3 significant contracts. First, the company will be providing construction management services for the construction of Expo Park Pampulha in Minas Gerais, Brazil. This project will deliver an $80 million conventions center complex with associated hotel and commercial buildings. Hill was also awarded 2 contracts to provide project management and infrastructure management services for the construction of 2 ethanol plants for Millenium Bioenergia S.A. The 2 plants located in Brazil have a combined total project value of $300 million.

Hill is also growing our hospitality portfolio in Egypt, where the company will provide project management services for the Talaat Moustafa Group's $250 million, 4 hotel program. The program includes the construction of Madinaty Four Seasons Hotel and the renovation of 3 other hotels: The Nile Plaza Four Seasons, the San Stefano Four Seasons and the Nile Kempinski Hotel. These wins represent Hill's growth in profitable markets and established clients, and we are confident they are precursors of future opportunities for

Hill.

To further detail Hill's 2018 third quarter results, I will pass the call to Greg Wolf.

Gregory T. Wolf ***Hill International, Inc. - Interim VP & Interim CFO***

Thank you, Raouf. I will start by providing our financials for the third quarter of 2018. Our total revenue for the third quarter of 2018 was $101.9 million, a decrease of 17.3% compared to third quarter of 2017. Operating loss for the third quarter of 2018 was $7.7 million compared to an operating loss of $1.6 million in the prior year's third quarter.

Net loss from continued operations was $8.5 million or $0.15 per diluted share compared to a net loss from continued operations of $1.6 million or $0.03 per diluted share during the prior year's third quarter.

CFR, which is included as a component of our total revenue, was $81.2 million and $95.8 million for the 3 months ended September 30, 2018 and 2017, which was 80% and 78% of total revenues, respectively.

The operating loss increase in the third quarter of 2018 was due in part to a reduction of total revenues in gross profit over the prior year's third quarter of $21.3 million and $4.2 million, respectively, as a result of that wind down of various projects in the Middle East and the United States.

The increase in operating loss in the third quarter of 2018 from the third quarter of 2017 was also impacted by increased selling, general and administrative, or SG&A, expenses of $2.5 million. This increase was comprised of $3.1 million increase in net foreign translation losses related to the unfavorable fluctuations, mostly due to the Turkish lira, the euro and the Brazilian real, plus an additional $3.1 million expense related to the Former Hill Founder and CEO incurred during the third quarter of 2018.

Partially offsetting these increases and SG&A in the third quarter of 2018 from the third quarter of 2017 were cost savings of $2.4 million in unapplied and indirect labor cost, as a result of our profit improvement plan and a decrease in bad debt expense of $1.3 million.

Adjusted earnings loss before interest, taxes, depreciation and amortization, or adjusted EBITDA, in the third quarter, was $5.3 million compared to an adjusted EBITDA for third quarter of 2017 of $4.9 million. Adjusted EBITDA is EBITDA adjusted for foreign currency translation losses or benefits and nonrecurring activities, such as the loss on performance bond, the Libya bad debt recovery, cost incurred with the profit improvement plan and other onetime costs, it is not a measure -- this is not a measure of performance under GAAP. A detailed reconciliation of adjusted EBITDA is included in the press release.

I'll now move on to our year-to-date results. Our total revenue for the 9 months ended September 30, 2018, was $328 million, which reflects a 10.1% decrease from the 9 months ended September 30, 2017. Operating loss was $16.4 million year-to-date September 30, 2018, compared to an operating profit of $1.1 million in the prior year. Net loss from continued operations was $23.2 million or $0.42 per diluted share compared to net loss from continued operations of $0.6 million or $0.01 per diluted share in the prior year.

CFR, again, is included as a component of total revenue, was $261.8 million and $293.8 million for the 9 months ended September 30, 2018 and 2017, which makes up 80% and 81% of total revenues, respectively.

The decrease in operating profit in the 9 months ended September 30, 2018, was mostly due to a reduction of total revenues and gross profit over the prior year of $36.8 million and $12.5 million, respectively, as a result of the wind down of the various projects in the Middle East and United States.

Operating loss for the 9 months ended September 30, 2018, was also impacted by a $7.9 million loss on a performance bond related to a claim submitted by a client in Kuwait. SG&A expenses for the 9 months ended September 30, 2018, as compared to the year-end -- year-to-date September 30, 2017, slightly improved by $0.4 million. However, year-to-date September 30, 2018, SG&A included a $9.2 million increase in net foreign translation losses related to the unfavorable fluctuations in various foreign currencies, which again, mostly pertains to the euro, Turkish lira and Brazilian real. And a $5.1 million cost increase related to additional resources needed to accelerate our financial statement filings with the the SEC.

These increases were offset against other SG&A decreases, including lower unapplied and indirect labor cost of $11.4 million year-to-date September 30, 2018, as compared to September 30, 2017, that occurred properly as a result of the company's profit improvement plan and a $3.2 million net benefit incurred as a result of a bad debt recovery from a Libyan client year-to-date September 30, 2018.

Adjusted EBITDA improved for the 9 months ended September 30, 2018, to $17.6 million compared to an adjusted EBITDA of $15.4 million for the same period in 2017. Again, a detailed reconciliation of adjusted EBITDA is included in the press release.

Our backlog, which as Raouf mentioned, reflects CFR improved quarter-over-quarter by $3.3 million to $819.7 million at September 30, 2018, as compared to $816.4 million at June 30, 2018.

Our quarterly and year-to-date financials were significantly impacted by foreign currency translation losses. I want to note that the majority of these losses are a result of intercompany payables and receivables, loans and notes made between various Hill subsidiaries within the company that have accumulated over a long period of time and have yet to be settled. Our focus for the end of the year is to evaluate these balances owed between these entities and reduce our exposure to these losses in a way that will prevent tax impacts or that will have the least impact to our financial position by individual legal entity. Again, these are nonoperating losses.

This concludes the highlights of our quarter-to-date and our year-to-date financial results. I'll not turn it back over to Raouf.

Raouf S. Ghali *Hill International, Inc. - CEO & Director*

Thank you, Greg. I would like to just reiterate that 2018 has been a year of transition, with restatements, accelerated SEC filings to get current, the profit improvement plan and organizational leadership changes. With all this behind us, we are excited about the future of Hill. Also, I would like to highlight that although our revenues are down in the quarter or year-to-date, 2018 compared to 2017, our adjusted EBITDA improved to $5.3 million in third quarter 2018 compared to $4.9 million in third quarter 2017, and improved to $17.6 million year-to-date 2018 compared to $15.4 million year-to-date 2017.

2018 has absorbed onetime costs for the profit improvement plan and other getting current cost, prior to management executive cost and performance bond cost totaling over $25 million. These costs will not be a reoccurring in 2019 and beyond. This is why we are very excited about the near- and long-term future of Hill, as we strengthen our cash flow and balance sheet while growing our brand and market share throughout the world.

At this point, we would like to take a few questions from those on the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Pete Enderlin with MAZ Partners.

Peter Enderlin

Raouf, this is sort of a broad long-term question. There is a greater recognition these days that there's tremendous traffic congestion and it's a severe problem in a lot of emerging market cities. Major solution to that is probably more rail, more mass transit, and you guys have had a lot of local experience in doing those kinds of projects. So from an organizational standpoint, can you build a specific vertical market capability in those markets to focus on that opportunity? Or how would you go about trying to address it?

Raouf S. Ghali *Hill International, Inc. - CEO & Director*

We are addressing it. I think we are very strong, first of all, in infrastructure and transportation market. We continue to look at it, when you say vertical, you mean on buildings?

Peter Enderlin

No, no, I mean specifically the rail construction program management...

Raouf S. Ghali ***Hill International, Inc. - CEO & Director***

So horizontally, you mean? Because you...

Peter Enderlin

Yes.

Raouf S. Ghali ***Hill International, Inc. - CEO & Director***

That's why I just wanted to clarify, just to make sure that I'm responding correctly. We feel very bullish, that's one of the reasons we feel very bullish on the U.S. market. We are very well positioned on all the horizontal construction that we think is going to be coming down. We see it only growing. We see the demand growing. And in all the regions we are currently in, all our clients have indicated a very strong pipeline for future programs to come down. So I agree with you.

Peter Enderlin

But for mass transit, mass transit specifically is a somewhat specialized category and you have done a lot of it. Would you build sort of permanent teams on a country-specific basis? Or would you just use sort of floating teams that you can assemble as needed to go from one geographical region to another?

Raouf S. Ghali ***Hill International, Inc. - CEO & Director***

Some of our leadership has that expertise. Mass transit is light rail and metros as well as now, I think, there's a big push for high-speed rail as well. We have that both globally and domestically in the U.S. Some of our leadership team has that expertise. We currently have them in there, and we will -- we grow through them, and we just grow the team as required on the different opportunities as they arise. But the core team is already in.

Peter Enderlin

Okay. Yes. And then focusing more on the U.S., you mentioned preconstruction services and post-construction. Can you give us some sense of the timing or the pace of when you would move more actively into those 2 areas?

Raouf S. Ghali ***Hill International, Inc. - CEO & Director***

We are moving towards the preconstruction already in U.S. in some of the locations, where we are getting involved with clients, in particular, private clients on the preconstruction phase to help them out with preplanning. So that's already in the works and we are growing it as we see fit. Obviously, we don't want to invest a lot of money up front with it. So we are going as the need comes with current existing clients and new clients that we can source. On the post-construction, we're looking at it to make sure that we don't increase our risk profile for the facility management portion. Facility management is really -- can be looked at in 2 different ways. You can do facility management solvency service or the full facility management. We're looking at the -- at both of those with market studies and seeing, based on the clients we already have captured, what is a good fit to that. Internationally, we are already doing this in several places, very profitable.

Peter Enderlin

And Raouf, can you give us a sense of on a long-term basis, which of the 2 categories we were just talking about, pre and post, would have greater revenue opportunities?

Raouf S. Ghali ***Hill International, Inc. - CEO & Director***

I think, the post will have, because they are longer-term and much larger in nature. The preconstruction will give you less of the revenue opportunity. But also, they'll give you downstream cross-selling opportunities. So -- because you're with the client right up front in the early design and preplanning phase.

Operator

And our next question comes from line of Matt Sweeney with Laughing Water Capital.

Matthew Sweeney ***Laughing Water Capital - Managing Partner & Portfolio Manager***

Raouf, a question for you. It's been, I guess, almost 4 years now since it's been business as usual for Hill International between all the boardroom battles and the restatements. Can you just talk a little bit about what your strategic vision is in terms of plans for the future in context of, historically, this was a company that was focused on growth through acquisition? And we're kind of left with the collection of assets now that are arguably under scaled in couple of the regions. So how do you think the right way to address that going forward is? And what is the strategic vision?

Raouf S. Ghali ***Hill International, Inc. - CEO & Director***

Well, thank you. Very good question. I think in the past, we were a mixture between organic growth and acquisitions. That's my firm belief. A lot of our growth was spurred from both of them. For right now, the company, as we see it, we are going to be focusing on organic growth. We are in all the right areas whether it's in U.S. international, we are with clients that have a lot of need for our services right now. So we want to grow and grow in critical mass in existing locations, because through the critical mass is where we get, and we should see a lot of operating profit and profits coming down to the bottom line rather than opening new offices and going to new regions. So the focus and the strategy and the near-term strategy is growth from the locations we're in, geographically, and within the scope that we currently do. We are not looking at any acquisitions in the near future.

Operator

(Operator Instructions) Our next question is from Chris Colvin with Breach Inlet Capital.

Chris Colvin

I wanted to first say thanks for clarifying that the FX is a nonoperating loss, that's helpful. Secondly, great to see that the backlog is up from last quarter. So congrats on that and hopefully it's a positive trend. My 2 questions are just to confirm, one, the backlog isn't CFR? I believe you said it is but please confirm that. And then two, can you please define bookings?

Raouf S. Ghali ***Hill International, Inc. - CEO & Director***

Sure. Very good questions, both of them. Let me address them. Let's start with backlog, because I believe there has been some confusion. Backlog is a CFR number. Bookings is a mathematical plug between backlog at the beginning of a period, backlog at the end of the period and the CFR during that period. It is not necessarily though a number that's representative of the state of the business. Because in some situations, projects that are in backlog can be canceled or some projects that we may have been selected for have not made it to backlog yet, as they are not fully executed. Therefore, we believe that the sales numbers is a more meaningful number to assess the health of the business than bookings. As described, going forward, we will always refer to CFR numbers when we are talking about bookings and sales. We are pleased so far that this year's sales have been running around $100 million per quarter, and again, this is a net number and it's equivalent to CFR. We are pleased that our backlog is a little bit up this quarter, and we are confident that the trend will continue.

On the second question, I believe, you talked about the sales number. And again, maybe I take this time to leave you some of the confusion on the sales numbers. Sales-to-date, as of the third quarter is $302 million. I believe our Former CFO had indicated the sales number being $200 million at that time. Just to correct, our Former CEO, and just in case I said something wrong, as of the second quarter of 2018, our Former CEO had mentioned the $200 million number and it's consistent with our sales of around $100 million per quarter. So we're pleased to see that we continue on the same trend. Future-wise, we're bidding on larger projects. So again -- once again, we're confident that our future sales are going to continue to be strong and continue maybe to grow even better.

Chris Colvin

Okay. It sounds like your sales, what should lead to future revenue, I think, you said was $300 million and that's ahead of your year-to-date CFR of about $260 million. So that should be -- that's good to hear. So I appreciate it.

Raouf S. Ghali ***Hill International, Inc. - CEO & Director***

Thank you.

Operator

And our next question is from Charles Neuhauser with Mainwall Investment.

Charles Neuhauser

Just to take that one step further, my understanding is that the $400 million level on an annual basis, you would view as a base figure from which you expect the company to grow. And I also think I heard you say that the extraordinary charges or costs this year were around $25 million. Now my question is, with the base $400 million in annual -- annualized today, do you expect to become cash flow positive going forward?

Gregory T. Wolf ***Hill International, Inc. - Interim VP & Interim CFO***

Yes, I'll take that question. That's a good question. I think we do believe that it will be cash flow positive going forward. We're taking $25 million, which were cash items out of the system going into 2019. So I believe that in 2019, we should have a stronger cash flow position. We should be equating more to EBITDA going forward, so we do think that we are going to be in a much better cash flow and the balance sheet position, as we move through 2019 and forward.

Charles Neuhauser

Okay. Again, not to pin you down but if you said -- did you just say you would have expect -- you will expect the EBITDA that you produce next year to essentially be positive cash flow?

Gregory T. Wolf ***Hill International, Inc. - Interim VP & Interim CFO***

Well, if you take these out, we're on an adjusted basis right now. So these items would not be there. So on a straight EBITDA basis, you would be there.

If you look at our press release, we have the adjusted EBITDA numbers in there. So on the adjusted basis, we take those out of the system, that's where you'll pick up some cash flow over time.

Charles Neuhauser

Right. And you -- again, sorry, if I'm a little confused here, but you were talking about the intercompany liabilities or something like that. Are those going to have a negative impact on cash flow in the third fourth quarter of this year?

Gregory T. Wolf ***Hill International, Inc. - Interim VP & Interim CFO***

No, actually they'll have no impact on cash flow because they are non -- right now, they are effectively noncash. So what it is -- just to clarify, we only have notes and loans and receivables throughout all the different entities that we own. It doesn't affect any of the consolidation. But what it does affect as it causes the FX on our P&L, which is effective noncash piece. And so what we're looking to do is to move that down to some equity components, where we can, as long as we don't have withholding tax implications by country.

Charles Neuhauser

Okay. No, that's good. I just, again, appreciate the clarification that is a non -- those are noncash adjustments.

Gregory T. Wolf ***Hill International, Inc. - Interim VP & Interim CFO***

Correct.

Operator

And I'm not showing any further questions. So this does conclude today's conference. Ladies and gentlemen, thank you for your participation and have a wonderful day. You may all disconnect.