NASDAQ:TTEK Q4 2025 Earnings Call Transcript

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Melissa | Conference Call Operator:

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Dan Batrak | Chairman & Chief Executive Officer:

Thank you very much, Melissa, and good morning. Welcome for our fourth quarter and fiscal year 2025 earnings conference call. And I'd like to start this morning with sharing with you that I'm very glad to report that we had an excellent fourth quarter and record financial performance for all the fiscal year 2025. But before I actually get to the numbers, I'd like to take just a moment here at the beginning to discuss how we successfully navigated this extraordinary year and ended up with these record results. By staying focused on our high-end consulting and our leadership in water, we've built an enduring competitive advantage and a long-term client-based trust with our end clients that we work with. Our leading the science approach has provided us with a significant competitive advantage and highly adaptive workforce, long-standing client relationships that have ended up resulting in sustained demand for our services over decades. It is this focus that has allowed us to successfully navigate the recent changes in the U.S. federal government's priorities and emerge with financial records and financial performance for fiscal year 2025. More importantly, as I look into fiscal year 2026 and beyond, I see our high-end water services in higher demand and more critical than ever to the fastest-growing markets in the United States and internationally. Today, Steve Burdick, our Chief Financial Officer, will provide additional details of our financial performance, both in the quarter and the year. And I'd also like to welcome today with us Roger Argus, our newly appointed president here at Tetra Tech, who I personally have worked with for over 30 years here at Tetra Tech directly. Obviously, Roger goes back in the market and industry even farther than that. He brings a great understanding of our clients and our business worldwide. and he's spearheading some of our highest opportunity growth initiatives that we have in the company today. Roger will provide an update of our water-focused growth markets during his presentation this morning. And I would like to share with you an update of our financial performance and our business. We had record results for the fourth quarter and for the entirety of fiscal year 2025 with record highs across the board for net revenue, operating income, and earnings per share. The fourth quarter results provided us with strong momentum as we exit the fiscal 2025 fiscal year and enter fiscal year 2026. These results are very broad-based, demonstrating the strength across all of our business sectors and our markets globally. We finished fiscal year 2025 with a strong fourth quarter, resulting in record net revenue, record operating income, and significant operating margin expansion. We had record net revenue of $1.07 billion, which is up 10% from the prior year. We significantly expanded our margins to the highest level in more than 30 years, which results in our operating income being up 23%. more than doubled the rate of revenue growth and reaching $168 million for the first time. And finally, the growth rate for earnings per share was even higher, up 29%, reaching 44 cents for the quarter. I'd like to present our performance by our segment, or our client segments. The Government Services Group had an excellent year and delivered an extraordinary fourth quarter. In the fourth quarter, our GSG segment revenue grew by 17% rising to $396 million compared to $338 million last year. GSG segment also set a new record for margin performance at 22.9% for up 330 basis points from the prior year. This performance was driven by strong execution of our water infrastructure and our digital automation work for state and local clients. high utilization across our U.S. operations during the completion of our fire disaster response work, and the reduction in our low-margin USAID work. The Commercial International Group also delivered a strong fourth quarter and strong year. Our Commercial International Group's fourth quarter revenue was up 7% to $676 million, and the CIG, our Commercial International Group's margin, excluding Australia, was up about 60 basis points in the quarter. Now, I'd like to provide an overview of our performance by our end customers. In the fourth quarter, international work was about 45% of our overall business and growing at a 9% rate. International organic growth included increases in the United Kingdom's water business and a strong growth in our Canadian clean energy practice. In the United States, our state and local markets continue to be very strong with a 19% growth rate driven by municipal water treatment and digital water modernization, especially in the water stressed regions of Texas, Florida, and California. Without the contribution of the disaster work in the quarter, our state and local work was up 13% year over year. U.S. commercial work overall was down slightly. driven by reductions in renewable energy work, but partially offset by growth in other sectors. Our U.S. commercial work includes some sectors that have extraordinary growth rates in the quarter. For example, our high-voltage transmission work in the United States is rapidly growing due to expanding energy demand, which is often associated with data centers. And finally, our U.S. federal work is now 21% of our business compared to 31% a year ago. This quarter, our federal work was up 22% from the prior year, primarily for work with the US Army Corps of Engineers designing flood protection structures and providing disaster response services. I'd like now to discuss our backlog. We had a strong quarter of contract awards, ending the quarter with $4.14 billion in backlog during a record revenue quarter. As I've stated previously, we use a highly conservative approach to backlog reporting by including only work that is contracted, funded, and authorized. The backlog we have today is of higher quality than ever before with higher embedded margins and with a higher portion of fixed price contracts, which gives us even more opportunity for margin expansion. This quarter, we were awarded over $1.2 billion in new contracts with U.S. defense agencies that cover both U.S. domestic and international operations. We announced another great win with United Kingdom for Portsmouth Water with a $23 million contract that you can note on the webcast that we have here. And we won two new awards for high voltage transmission work in the United States and Ireland. both areas where data centers are driving investments in power generation and transmission. Our US high voltage transmission practice is now growing their backlog at 120% rate year on year here in the US. At this point, I'd like to turn the presentation over to our Chief Financial Officer, Steve Burdick, to take us through the financials for fiscal year 2025. Steve?

Steve Burdick | Chief Financial Officer:

Well, hey, thank you, Dan. I'd like to now provide an update of our fiscal 2025 results, working capital, cash flows, and capital allocation. But before I dive into these results, I want to point out and remind us all where we started the year. We initiated our 2025 revenue and earnings guidance in line with our longer-term 2030 goals. Now, despite having our largest single client cancel hundreds of contracts midway through 2025 and other headwinds that could have knocked out anybody else, Tetra Tech delivered all-time high revenue and earnings. And because of our high-quality clients and talented project managers across the globe, we generated a record-setting cash from operations that approached a half billion dollars. Not only am I proud of our team's ability to execute on our 2025 results, I'm even more positive on our team's ability to execute on our long-term strategy in 2026 and beyond where our market-leading services are focused either directly or as a first derivative to our clients' water investment opportunities. Now, as Dan discussed earlier on this call, our market-leading focus on the front-end consulting and design for water and environmental projects are carrying higher margins across all of our end markets. As such, even as the fiscal 2025 revenue was up a solid 7% over last year, Our operating income increased at a higher rate of 18%, and EBITDA for the year increased 13%. These results for the year further support our long-term strategic goals to increase net revenue while improving EBITDA margins by 50 basis points annually. I do want to point out that, as you can see here, our 2025 EBITDA margins and net revenue came in at a better 14.3%, which is an increase of over 80 basis points for this year as compared to last year. As a result of our ability to enhance our profit margins and further manage our working capital, we were able to increase EPS by 24% over last year to $1.56. Now, regarding our working capital, Cash flows generated from operations for fiscal 2025 were $458 million, which represents a 28% improvement over fiscal 2024. And consistent with the last 20 years, these operating cash flows have continued to exceed net income by more than 100%. Our focus on working capital and cash flows has resulted in our DSO reflecting an industry-leading standard of 55.7 days. This lower DSO metric provides significant insight into our core business as it reflects the outstanding work that our project managers lead relative to higher quality projects and highly satisfied clients in our broad portfolio across all of our end markets and geographies. Our net debt amounted to about $600 million, and our net debt on EBITDA was at a leverage of 0.9 times, which is lower than our leverage one year ago when it stood at 1.8 times. As we continue to execute on high-quality operating results with increasing margins, operating cash flows and excessive net income, and lower working capital KPIs, we will continue to provide higher returns for our shareholders. Shareholder financial returns are reflected in an improving return on capital employed, which stands at over 20%, which is among the best in the industry. For those following along in the presentation, I would like to now present a capital allocation overview. We have a very strong balance sheet, probably the strongest balance sheet in our history. with well over $1 billion in available liquidity as we have revised our capital structure in the last year to take advantage of the credit market to support our strategic growth opportunities. Now, Roger will discuss our strategic growth areas later in this presentation, but I do want to point out that we have a significant amount in liquidity available to invest in organic and inquisitive growth opportunities in order to take advantage of these key business opportunities. These opportunities include the technology and automation, which continues to provide us a dominant position in the market, and for acquisitions of technical leaders such as Sage and Karen Walsh. Regarding our dividend program, I want to announce that our board of directors approved the fourth quarter dividend, which is a 12% increase year-over-year to be paid in the first quarter. This is our 42nd consecutive quarterly dividend with annual double-digit increases in amounts paid. Based on the lower leverage, we have contributed, we have continued our stock buyback program this year. In 2025, we brought back a total of $250 million, which includes $50 million in stock buybacks in the fourth quarter. We do have about $598 million available in the stock buyback plan, approved by our board as part of our capital allocation strategy. You know, I'm really pleased to share these financial results for fiscal 25, which has enabled us to increase shareholder returns as we're paying increasing dividends, increasing our stock buybacks, engaging in accretive acquisitions, all the while leveraging our balance sheet. I want to thank you for your support. And I'll now hand the call over to Roger to discuss Tetra Tech's future opportunities in 2026 and beyond.

Roger Argus | President:

Thank you, Steve. I'd like to highlight today's major growth drivers that will fuel Tetra Tech's growth in FY26 and beyond. For those of you following along on the webcast, I'd like to first draw your attention to the center of the slide. Greater than 85% of Tetra Tech's business is providing water services to our clients. Our high-end water services cover the full lifecycle of water use, from sourcing and management to reuse and treatment. These services also include coastal resilience for flood protection, expansion of ports and harbors, digital automation and control systems to optimize water management and efficient use, as well as water for mining, power generation, and manufacturing. The drivers shown here represent large global investments in water-reliant infrastructure and share a few common characteristics. These drivers represent a total addressable market for Tetra Tech services measured in hundreds of billions of dollars. Tetra Tech is already performing work in each of these markets and is well-positioned to benefit from these growing investments. In fact, Tetra Tech currently holds the contracts master service agreements and frameworks with more than $30 billion in capacity to perform these services for our clients. Global investment in each of these markets supports the demand for Tetra Tech's high-end water services and is driving Tetra Tech's growth. In the next two slides, I'd like to highlight two of the fastest-growing areas and illustrate how Tetra Tech is capitalizing on these trends. First, I'd like to talk about the data center market. There are estimates as high as $1 trillion to be invested over the next 10 years to expand data center processing capacity to address the needs of AI. The water demand for these systems is enormous. A large data center, for example, consumes about 5 million gallons of water per day. This sector's growing water footprint is reshaping how and where communities invest in water-related infrastructure. This slide illustrates that the data center market is not just the building housing the chip stacks. In fact, many data center operators are using in-house template designs for these buildings. More importantly, the data center market includes resource management needs for water and power, which are geographically specific for each facility. Tetra Tech's high-end water expertise and geographic footprint allow us to address these requirements, which are unique for each data center. As we look at this figure from left to right, first, it's important to note that more than 97% of water used by major data center operators is currently purchased from municipal drinking water systems, many of which are already under strain. Let me provide you with just one example of how water demand for data centers is driving growth for Tetra Tech. Just last week, it was announced that Texas will make the largest investment in its water supply in the state's history. Voters approved a proposition authorizing $20 billion to be spent on water systems, including water supply projects to address the growing requirements of data centers. Tetra Tech currently holds more than 60 state and local contracts in Texas. We are already working with these clients, providing our full suite of water services, and we will directly benefit from this new funding. In addition, within the data center itself, Tetra Tech provides water handling, digital control system automation, and commissioning services directly to the building operations. In fact, we currently hold contracts with more than a dozen of the major data center hyperscale and co-location operators to provide these services. And ultimately, these facilities require our expertise for water reconditioning for reuse or treatment for disposal. This work will either be done through contracts with data center operators or with local municipalities to expand their wastewater management capacity. Defense budgets in each of our major geographic markets is up significantly. The U.S. is up $150 billion. The U.K. is up $4 billion, and Australia is up $4 billion on already large annual budgets. These funding increases will be used to expand defense facilities, including ports and harbors, strengthen coastal resiliency and flood protection, and address water contaminants of concern, such as PFAS. The expansion of naval facilities is included as a key focus of this funding. This will result in the growth of Tetra Tech's work in ports and harbors including evaluation, planning, and design of marine infrastructure. We currently provide these services to our defense clients in the U.S., U.K., and Australia through contracts with an aggregate available capacity of more than $10 billion of the $30 billion I referred to earlier. I'd like to provide one brief example of how Tetra Tech is benefiting from this increased funding. In fiscal year 25, the Australian Department of Defense awarded Tetra Tech a $67 million contract to support infrastructure upgrades to facilities along the northern shore of Australia. The scope of this contract includes front-end studies, analytics, and project management. to support governmental, regulatory, and community approvals for these critical upgrades, which will ensure safe, secure, and resilient operation of these defense facilities. Coastal resiliency work, which includes flood protection to strengthen the facilities and safeguard the lives of military and civilian populations will also receive additional funding. Tetra Tech has long been a leader in flood protection and, in fact, in the fourth quarter, we've been awarded about $1 billion in new contract capacity from the U.S. Army Corps of Engineers. Additionally, these increased defense budgets will provide greater funding to Tetra Tech's ongoing defense contracts to eliminate sources and clean up water contamination related to PFAS and other persistent chemicals in the environment. In the fourth quarter, we were awarded a new $240 million contract with the Navy, which is intended to focus on assessment of contamination in water at naval installations, including sea bus. In summary, we are very excited about the opportunities these growth drivers present and the resulting growth that Tetra Tech can achieve. I will now turn the presentation over to Dan. Thank you, Roger. Thank you very much.

Dan Batrak | Chairman & Chief Executive Officer:

And I'd like to provide an overview of our outlook for fiscal year 2026 by each of our end customers. Each of our customer sectors have growth drivers relevant to our business, as you've heard from Roger and myself. And I'll start with our international growth. International growth is forecasted to grow at a rate between 5 and 10% in fiscal year 2026, supported by the $130 billion in aid program in the United Kingdom. Programs like the $200 billion Canadian infrastructure program that's just recently been passed. And in Australia, the spending and preparation for the Olympics that are going to take place in Brisbane. Our U.S. commercial work is forecasted to grow in fiscal year 2026 at a rate between 5 and 10%, supported by water demand for data centers and advanced manufacturing and power-related services to address the U.S. energy demand that is increasing so quickly. Our U.S. state and local work is forecasted to grow at a 10% to 15% rate, which is very consistent to what we've seen over the past several years. And it's being driven by strong and sustained budgets for municipal water supplies and digital water modernization. And finally, our U.S. federal work is forecasted to grow at a 5% to 10% rate. is expected to ramp up over this range throughout the year as the procurement processes align with the new priorities of the new administration and budget increases are implemented that are associated with the one big beautiful bill act that was passed just recently. Now we'd like to present our guidance for the first quarter and for the entirety of fiscal year 2026. Our guidance is as follows. For net revenue for Q1, It's for a range of $950 million to $1 billion with an associated earnings per share of 30 cents to 33 cents. For the entirety of fiscal year 2026, our net revenue range is for 4.05 billion to 4.25 billion with an associated earnings per share of $1.40 to $1.55. Now, if you're following along with the webcast, you can see these assumptions, and I'll highlight them very briefly. It does assume within this guidance a charge for intangible amortization of $27 million. We anticipate depreciation of approximately 25 million, interest expense of 30 million, an effective tax rate quite similar to this last year of 27.5%, and does assume that we have 264 million shares of Tetra Tech stock outstanding. And as in the past, These guidance numbers, both for revenue and earnings per share, do not include any anticipated contributions for acquisitions, but they will be, we do expect them to contribute to the year, and we'll update our guidance accordingly as they join the company. In summary. We had a record fourth quarter and record fiscal year 2025, which most importantly, has positioned us for an excellent beginning to the 2026 fiscal year. Our focus on high-end consulting for water and environmental priorities is absolutely aligned with the long-term trends of supplying clean water to our communities, water supply for manufacturing, and a healthy environment for our children, all of which are enduring drivers and are not measured in years, but are measured in decades. The company has never been in a better financial position, as Steve Burdick, our CFO, just outlined. And we're in an excellent position to support our organic growth and to invest in having the best partners out in the industry actually come join us here at Tetra Tech, actually improving our growth rates, improving our margins, and making Tetra Tech even more competitive in the future. And with that, Melissa, I'd like to open up the call for questions.

Melissa | Conference Call Operator:

Thank you. The question and answer session will now begin. Please be aware that there will be a 30-second pause in our webcast to allow for buffering. At this time, audio participants are invited to submit their questions. Please remember to mute the audio function on your computer before you speak. If you are using a speakerphone, please pick up the handset before pressing any numbers. If you would like to ask a question, please press star 1 on your touchtone phone. Our first question comes from the line, of Tim Mulroney with William Blair. Please proceed with your question.

Luke McFadden | Analyst, William Blair:

Hi. This is Luke McFadden. I'm for Tim. Thanks for taking our questions this morning. So, it looks like your backlog was about flat year over year. Your guidance calls for organic growth of 8% at the midpoint for fiscal 2026. Both of these figures exclude USAID, so it feels apples to apples. So can you maybe just help us understand in a little more detail why you'd expect revenue growth to be so decoupled from backlog growth this year?

Dan Batrak | Chairman & Chief Executive Officer:

That's a great question. That's actually a really good question. In fact, we began the foresight and expectation of that decoupling actually in our last investor call 90 days ago. I think in a call we had on the previous quarterly results, they actually indicated that expected backlog to be flat, in fact, even down. And with it coming out flat, in a certain extent, it actually was at the upper end or surpassed our expectations. And if you take a look at the backlog, there's a couple things going on. Number one, the U.S. federal government's backlog or the funding of their tasks have become much shorter. So, instead of being funded for six months or for a full year, we're being funded for almost like a book and burn, one quarter at a time. So, we're seeing the visibility actually shrink with the U.S. federal government, but not the actual spending of revenue. We're just getting the work in smaller pieces and more frequent quarterly task orders. I will say that if we actually tracked and reported our backlog similar to most others in this industry, our backlog would be up very, very significantly. It's been an amazing federal government quarter of new orders, of new contracts that have been awarded. And so our contract capacity has gone up a lot. In fact, we've seen it grow by about 15%. And I think the comments I had earlier that we had well over a billion dollars in new contract awards with the Corps of Engineers, although the task orders coming out are much smaller, shorter duration, and a quicker burn. Now, you'd think that if that was the case and the rest of our business was static, you'd actually see the backlog go down. But we've seen our state and local work and our U.S. commercial and international backlogs actually growing fast. In fact, they've grown enough to keep our backlog flat sequentially, which is what you've seen in the results, as you've just indicated. So, that's why we're actually seeing a growth in, as I've just indicated, 5 to 10% in U.S. commercial, in international, 10 to 15% in state and local, all with growing backlog. And, in fact, that growing backlog has been enough to offset the reduction in the duration of the task force we've been getting from the federal government. So that's where you see the decoupling. I know it sounds like a lot of detail, but it's something we've seen coming since this new administration has been in. We've been watching the backlog drop, irrespective of international development with the federal government, but it doesn't mean less revenue. It just means that we're getting more smaller task orders on larger contracts that we've actually had. So I know that's a bit of detail, but I think that decoupling is going to be for a good portion of this fiscal year 2026. But I think as the U.S. federal government gets its sea legs under it with respect to more contracting officers in place, gets the cadence of task orders that actually come out a little bit longer duration, you're going to watch the federal government's task orders get larger through the year, and you'll actually watch that begin to climb not driven so much by commercial, state, local, and international, because they're already very strong, but actually returning a contract cadence with the U.S. federal government. I know it's probably a lot of detail, but There's a lot of pieces we're looking into that that actually underpin how we're seeing very strong organic growth, but it's not being seen as directly correlated to the backlog, which we've seen the case for many, many decades here. But there's no administration that's really changed that because of the U.S. federal government's task order issues.

Luke McFadden | Analyst, William Blair:

Thanks, Dan. That's really helpful. I appreciate it. And maybe pivoting to performance in your international business for my follow-up, which came in stronger than we were expecting for the fourth quarter and had a nice pickup from the third quarter as well. Can you walk us through some of the puts and takes on each of your three business lines in a little more detail here, where you saw strength and how you're thinking about the three main geographies as you move through fiscal 2026? Thanks.

Dan Batrak | Chairman & Chief Executive Officer:

Yeah, it's interesting. It's really that growth was really driven by a change in one geography, but I'll start with the strongest areas for us. The water programs, those have been the biggest underlying drivers for our United Kingdom and Europe, which is primarily Ireland and Netherlands operations. That's been growing at about a 10% rate. It's been the strongest. In fact, the water component of our UK and Europe operations have been even at a higher rate than that. So that's continued. I would say there's been little change in the previous quarters. So that's really been our top growth rate and top performer of our international geographies. Canada's been good, and I actually think it's going to get better. For those that I've spoken with at different conferences and seminars, I think on a relative basis, Canada may be the biggest, one of the biggest drivers. And I think that the short-term disruption of tariffs between the United States and Canada have caused some disruption. I am totally convinced that Canada is going to remain a major trading partner with global economies. And if it can't come down south, it's going to go east and west and, in fact, north through the Arctic trading routes that are now open. And you saw that Canada just passed its largest infrastructure and spending bills at $200 billion U.S. Canadian, of course, much larger numbers. And Canada is growing, as it has been, at about 5%, 6%. That's been very strong for us. But the item that's been – that was a change this last quarter has really been Australia. And Australia had gone from shrinking or reducing its revenue contribution by 10 to 15%. I think we've seen it kind of bottom out. And so, in a year-on-year comparison, it's getting closer to flat. We did have a couple percent contributed by the SAGE acquisition that came in in the fourth quarter. So, it really didn't add much at all for fiscal year 2025, a little bit for the fourth quarter. But Australia actually hitting the bottom with respect to reductions. That is the big change. So, if you go from a minus 10 or 15 in Australia and you move that to a zero, that largely accounted for that 9% increase. And I actually think that during the year, fiscal year 2026, it's going to start ramping up. Now, one, we're in Australia specifically, because that one, when you're at the bottom, there's not really too many directions to go from there, I hope. And two, we're seeing more funding and actually infrastructure projects moving forward at the very front end for the Olympics that are going to take place in Brisbane. who's the firm that would be engaged in it very early on, that's up front, planning, permitting, geotech, all the initial design, technology selection for all the different venues, transportation, and others. So I think that's going to be a good number for us, and as it was Australia was the change in the quarter that drove that number.

Luke McFadden | Analyst, William Blair:

Appreciate all the color. Great. Thank you.

Melissa | Conference Call Operator:

Thank you. Our next question comes from the line of Sabah Khan with RBC Capital Markets. Please proceed with your question.

Sabah Khan | Analyst, RBC Capital Markets:

Great. Thanks, Sandra. Good morning. I'm just kind of following on the same line of questions along the outlook, I guess. You know, just given some of the moving pieces in the backdrop, how did you sort of build out that range for the fiscal 2016? It's more thinking on the top line versus the EPS line. If you can just maybe walk through. You know, as it comes to disaster relief, some of the other moving pieces, how should we think about the low end versus the high end? Or, you know, what needs to happen for you to come somewhere in the middle of that range? If you could just share some of the puts and takes that you consider as you built out that range for the top line. Thanks.

Dan Batrak | Chairman & Chief Executive Officer:

Yeah, so top line or revenue growth, I'll start with, you know, what's sort of the midpoint? So, I would say that the numbers I just ran through, 5% to 10%, So, if you want to pick a midpoint of that, seven and a half, I'd say that's sort of the number we're looking at for international, U.S. commercial, and for U.S. government. And the 10 to 15 for municipal, you can pick a sort of a 12 and a half percent. If you took out disasters for this last quarter, they were at 13%, so right there. So, the midpoint is actually the midpoint of those growth. And if you take those numbers from this last year, you apply those growth rates, you'll find that we actually get to that midpoint or just over 4.1 billion for fiscal year 2026. Now, what could cause us to deviate up and down from that? It's not going to be perfectly linear. I will say that the U.S. let me use an example of the U.S. commercial. You saw this last quarter, we were at minus 2. I expect that it's going to remain very low. It's going to be below that 5 to 10% rate in the first quarter or two of fiscal year 2026. Because a year ago, we had a lot of renewable energy work. And some of the biggest projects were offshore wind. Now, these areas have been significantly impacted by policy and executive orders and other items. And so, that big headwind or the difficult year-on-year comparisons are Q1 and Q2. Now, we've got a very fast-growing transmission practice, high-voltage transmission. Other programs that we have here in the U.S. that Roger did a great job of outlining with respect to water supply for different manufacturing, which includes data centers, chip baths, and other reshoring. So, I think we'll be at the high end of that 5 to 10 at the latter quarter, so quarter three and four. So, look for that to ramp. I think the same is going to be true with the U.S. You've had some dysfunction, obviously, a six-week shutdown here with the U.S. government in Q1, which has already been included in our guidance for Q1. And some of the questions I've had are, what's the impact? of the shutdown and life got a little bit easier on that forecasting with the government opening up just last night. And so, we had a small impact that's actually embedded in our guidance both for the quarter and the year. For us, it was probably 15 to 20 million, and most of it came in the latter part of that six-week shutdown. We were really unaffected early on. So I think you'll watch federal government ramp also during the year. So we've got our 5 to 10, and I would say we're not going to start with a zero, like commercial, up to 10, but we'll start at 5, 6, and we'll end up at 10. International, you've already seen we're at the upper end, and the same is true with midpoint on state and local. What would drive us to the high end of this? I would say actually a little bit more clarity on international. I think international could move to the high end, and I'd like to see the baseline be 8, 9, 10, and actually the performance come out above that. And I think it would just be clarity with respect to tariffs and trading so that individuals can select what they're going to move forward with respect to their manufacturing. And I would say in the case of Canada, how quickly they can actually deploy what's just been authorized with their infrastructure work. I would say what also could take us to the high end, we've not included really any material dollars for the U.S. State Department. And we are still present, although I would say close to dormant in places like Ukraine specifically. But if that actually became more constructive or more funding came through it, that certainly could push it to the upper end. With respect to what could bring us to the low end, Well, they passed a continuing resolution to the end of January. And if we're right back here at the end of January and that they want to eclipse the new record they just set for the past six weeks, it's something you'd have to take a look at. Now, it's not really been much of a financial impact to us, this first six weeks of shutdown. But you have to take a look at each one of these as they come and what's impacted. So, I think unusual things like recessions and unusual things like a prolonged shutdown could drive us to the low end. Things that could drive us to the high end is a little bit more clarity on tariffs, which will help both on acceleration of U.S. commercial for reshoring here in the U.S. And honestly, a lot of activity internationally with respect to what they're going to move forward with, with respect to their own manufacturing. Is it going to come to the U.S., irrespective of the price increases on the tariffs, or are they going to have other trading partners? So a little more clarity on that. I'm not saying that high or low tariffs make a big difference, just clarity of what the number is might actually make a very positive construct for moving us to the high end.

Sabah Khan | Analyst, RBC Capital Markets:

Great. Thanks very much for that color. And then sort of just continuing on that discussion kind of post this continuing resolution, is it, I guess based on your past experience with such government closures, this two-part question, one, is it usually a smooth sort of turning on of all the functions that were stopped? And then second, we've been hearing some commentary about, you know, with the EPA just taking a while or just kind of shutting down on issuing permits, et cetera. Has that been a headwind, and where do we stand on that now on the EPA front? Thanks.

Dan Batrak | Chairman & Chief Executive Officer:

Yeah, good question. I would say that when we're in what I would call discretionary revenues from the federal government, it ramps back up slowly. But most of our revenues now have actually transitioned because of what took place in fiscal year 25 to essential services. So, we really didn't have that much of it put on hold for the federal government because a lot of our revenue is being driven by Department of Defense. So, you'd say, is it going to ramp back up? My comment would be it didn't ramp back down. So, we didn't really see that as an impact. So, I think the federal government's not going to see much of, you know, disruption from having gone down and back up. Now, with respect to permits coming out of EPA, we don't do a lot of work that is driven by federal regulation that requires EPA or national or U.S. federal either headquarters or region approval before it goes forward. There's a little bit of it where they're co-regulated. There's compliance both at the federal and state level. You need sort of two sign-offs. So that's actually affected some of the dollars. But for us, it's been pretty small. But I would say the one that's going to be seen a little bit more, interestingly enough, is actually in our state and local. And you would think that a government shutdown would not impact state and local. What have they got to do with the federal government? There's a lot of projects that have co-funding with the federal government. And I would say Department of Transportation, where you have large grants or other funding, incremental funding as part of projects that go forward, when those grants and other things are completely put on hold or you had to go back for sign-off or next milestones, you saw those projects put on pause or on hold until the government workers were actually back in place. So, I think the impact for us is going to be The federal government workers weren't there during the first half of our Q1 or the federal government's Q1 with respect to pushing out orders. And last I looked at the calendar, we're only a couple weeks away from Thanksgiving here, and then we're going into Christmas. So, it's not like you did a six-week shutdown, and then you're moving into blue skies. You're moving into holiday time. So, I think the optics of backlog or task order issuance could be impacted in Q1. And again, I think that's mostly optics, because we've got plenty of backlog to drive revenue right through this. But if you'd ask, what are you going to see from the impact of this slow comeback? I think you're going to see the optics on your backlog, and you may see some optics or short-term impact on funding through state and local for us. Permitting approvals for commercial clients and others, the minimus, the minimus. There just aren't that many programs except for Superfund that are driven by the federal government EPA approval process. So, I think it sounds like it's a big driver, not so much.

Sabah Khan | Analyst, RBC Capital Markets:

Thanks very much for that, Colin. Just one last quick one on sort of capital allocation and M&A. You've highlighted M&A as a focus, you know, firms call it in the medium-sized range, but can you talk about the general pipeline of those opportunities that meet your criteria? Things like the government shutdown influenced that either up or down in terms of the opportunity set or seller willingness. Thanks very much.

Dan Batrak | Chairman & Chief Executive Officer:

Well, I'm going to, I'll just say a few words on the, you know, from 100,000 foot sort of on the landscape, and then Steve will talk about the financial dollar set aside. But, well, this, the disruption, the volatility that's taken place in the markets because of the new administration, have, you know, have sent some shockwaves through some firms that have impacted them more than others. And I think for some, they've actually felt that through this volatility, a place that's safer is on a bigger ship. So if I'm in a small rowboat or a middle-sized boat and the waters get really choppy, maybe I want to get on a bigger vessel. So we've actually seen these small firms or even middle-sized firms actually come to market and be more transactable. So if they were not for sale before and all of a sudden you don't know what's going to happen, either on your federal government, state, or commercial, you know, maybe I'm going to go join a bigger partner who has a bigger platform as access to clients that are maybe outside the U.S. or that are more stable. And no doubt, Tetra Tech, if you're looking to join a technical leader and a market leader and you're in the fields that we're interested in, we're about as safe and as – as prosperous of a firm to join to progress where you're at and actually make your business even better and reduce your risk. So, I'd say there's more opportunity today because of this. And the other thing is that there's more available. And for those that are looking for the sale not to be their last move, but their next move to become better, Tetra Tech's the right home for them. So, I think pricing has become more moderated or valuations have come down a bit. I would say that the investment bankers are still asking for unbelievable, dizzying valuations if you're in power or if you're in data centers. But other than those two, I think valuations have gotten quite more modest. And the number of firms that are small to midsize have actually grown quite a bit. So I think our pipelines actually look bigger than we've seen before. No doubt with consolidation in the market, there are fewer large firms, the ones that Of course, the scarcity premium for these really large firms. But, you know, when those fit right for us, we'll look at those. We'll be opportunistic. If it fits right, we'll look at it. And maybe Steve can just say a word about is there anything outside our range or with respect to the ability that we could become constructive on?

Steve Burdick | Chief Financial Officer:

Yeah. So, I think, you know, as I talked about in my earlier comment, We've got a really strong balance sheet, and we're going to be able to use our balance sheet to make acquisitions that we think are going to have a long-term benefit. When I look at the capital markets and how we want to finance that, we have a bank credit facility that has 100% dry powder on our revolver. And it has options to increase it beyond what's in the facility now. So that's available. And outside of the bank market, you see that two years ago, we entered into a convertible debt. That capital is available at probably better terms today than two years ago. There are various capital markets and funding vehicles for us to really address anything that makes sense for Tetra Tech, either small, medium, or even larger firms in terms of who can join Tetra Tech.

Sabah Khan | Analyst, RBC Capital Markets:

Thanks very much. Okay.

Melissa | Conference Call Operator:

Thank you. Our next question comes from the line of Sangeeta Jain with KeyBain Capital Markets. Please proceed with your question.

Sangeeta Jain | Analyst, KeyBanc Capital Markets:

Great. Thank you. Thanks for taking my question. So one I want to ask about GSG margins. Outside of the elimination of USAID, can you tell us if there are other factors contributing to that margin expansion. Maybe it's an evolution of the mix of projects or more fixed price work that is driving that and how we should think about it for 26.

Dan Batrak | Chairman & Chief Executive Officer:

Yeah, well, no doubt, as you commented, we were finishing up a number of deliverables and items for the disaster response, which drove really high utilization in GSG. So that was, I would say, the single biggest driver that drove it up near 23% in a quarter. But the other two are just what you said is, one, we have more fixed-price work. One of our goals for a while has been to take our fixed-price amount of the work that we have. It has historically been, if you follow Tetra Tech or are an investor, reports that we have online and attached to our press release. Historically, we've been around 35%, a little more than a third fixed price. It's been a really focused over the past two, three years to move that to more fixed price as we've actually developed more tools that will make us more efficient. So we can give our clients a better price point with respect to performing the work and gives us higher margins. So, we did hit essentially 50% of the revenue that we had this last quarter was fixed price. That's the highest we've seen in, I don't know, I want to say ever, but certainly in many decades. So, that actually was a big contributor to it. And the other is mix. Areas that we have time and materials contracts on where there's very competitive weight structures, we do a bit of upfront design work. Actually, about 30% of it is very high-end upfront design. But when we move into what I'll call more detailed design, we end up being compared on a price point to some of these low-cost offshore design centers. And those carry lower margin. And we've been migrating out of doing that and moving our design work to earlier in the project execution cycle. And those that are already early, we're moving them into consulting or even advisory. So it is mixed shift. We are moving to where it's higher margins for the work, more differentiated work. Work is not generally competed. It's sole sourced. It's work under existing contracts and frameworks. And then the work that is closer to being commoditized, we're moving it more to the front end. So mix, number one. Number two, more fixed price. And then the third, of course, is when we do have very high utilization driving lower indirect costs. It then shows up in our margins, which was like the firework of this last quarter. So those are sort of the three big drivers. I will say we still have a lot more upside with respect to margins. One of it, I had aimed 50% for a target for fixed price work, even though we'd hit that this last quarter. I want to see us stay there for a few quarters in a row because some of that's individual project driven. But I think we're going to move our target from 50% up to 60% since that'll be our next milestone we move so we have more margin expansion there. And I think there's still a lot more margin contribution opportunity by using more of these digital tools. And, yes, that includes AI, and, yes, it includes technology. different SaaS products we have. But I think the next phase that will contribute is being much more efficient. And if we can apply more efficient execution to a fixed price contract, I think that means more margin expansion for the company and the shareholders.

Sangeeta Jain | Analyst, KeyBanc Capital Markets:

That's super helpful, Dan. And if I can follow up on the U.S. commercial business and the puts and takes that you talked about, renewables, kind of like be becoming a little bit softer and data centers and power transmission picking up can you compare for us if the scope of what you're losing on the renewable side is similar to what you're picking up on the power and data center side and if also the margin profiles are similar yeah so i will say of any of the uh areas that we have uh flux or change taking place

Dan Batrak | Chairman & Chief Executive Officer:

That's one of them that we're still, we're sort of in the middle of this transition. So the, we were doing much more full-scale permitting for siting, construction oversight for permit compliance for these renewable energy projects, and say one of the examples, of course, is offshore wind, where we'd have marine vessels and many other items. I thought Roger did a really good job of identifying that the work that we're looking to grow our data center work in particular, and I would say the high voltage engineering is much less on environmental compliance, which was being driven by, which was what we were doing for renewable energy, and much more for design for the commercialization and getting these different facilities online. So, I think that's the difference. So, on high voltage transmission, we're actually doing the high voltage engineering. We're doing the actual design of the transformer stations and the interconnects. So, we're actually doing what I would call very high end It's limited in service availability in the marketplace. There just aren't that many people that can do this. We're one of them. And so that's what I would say is different margins I think are actually a little better because of the scarcity of people doing this type of work for the grid and for high-voltage transmission. And I would say that it's just emerging now with our engagement in the data centers, which is not in the building itself. I thought Roger made a good point. The rush, the gold rush to do detailed design for the data center buildings itself, there's a lot of people rushing to that gold strike. But a lot of that work is being done internal. And a lot of it has been standardized so that all of the data centers are similar. And maybe that there's more miners than there are gold in that area. But actually those selling the products in order to go mine for that gold is how do you get 5 million gallons per data for a large data center? Where do you get that from? And as Roger commented, right now it's from the municipal municipalities. As water becomes more scarce, they're going to be looking for us to find other dedicated water supplies, groundwater, surface water, water reuse, water recycling. So, I think it's going to carry higher margins. So, where we're migrating into is higher margins and, frankly, less competition.

Sangeeta Jain | Analyst, KeyBanc Capital Markets:

Great. Super helpful. Thanks, Dan.

Luke McFadden | Analyst, William Blair:

Thanks. Thank you, Dan.

Melissa | Conference Call Operator:

Thank you. Our next question comes from the line of with National Bank Capital Markets. Please proceed with your question.

Mike | Analyst, National Bank Capital Markets:

Hi. Good morning, gentlemen. Hello, Mike. I was wondering if it's possible to get a bit of an update on your digital initiatives and maybe if you can talk about the clients where the adoption rates or the velocity is a little bit higher and why that potentially could be the case. Maybe any call that would be much appreciated. Thank you.

Dan Batrak | Chairman & Chief Executive Officer:

Well, the, let's see if I can just clarify and define the question. Because if it's our digital products is in our recurring revenue or SAS, Just to clarify that, Max. Yeah, it's interesting. That's been the one area that I would say we have been stymied or that has, it's the smallest area of revenue that was one of our growth areas. I will say that if you went back to May of 2024, our SAS or recurring revenue or our software products for subscription by our end clients, we'd reported was about $25 million a year. I think on an overall EBIT margin of about 50%. I regret to say that a year and a half later, it's still about $25 million and the margins are about the same. I will say what's been disruptive for us is our number one strategy was to take these software products, which were developed for our US government clients, Primarily, the government was the subscription, and I would say U.S. federal government. I would say the new administration has actually created more of a disruption there than anywhere else for us. Now, the good news is it's $25 million out of our total revenues at well over $4 billion. So, it's the smallest of small revenue numbers, but I will say our strategy to actually take it and to bring in unique products that would help the government in these areas dramatically has actually been put essentially on hold. There's been essentially a moratorium on new software packages for being purchased or leased or subscribed to at the federal government. We are retooling very quickly our go-to-market strategy to go to what we had called Phase 2, which has now become, so Plan B has now become Plan A, which is for things like Oceans Map, Instead of having it placed with the U.S. Coast Guard and the Navy and other specialty agencies within the federal government, we're going to ports and harbors and the individuals who actually have requirements to understand what's the impact of a oil spill or of a bilge discharge or anything else that may have been overboard actually in the local port and harbor environment. So, there's a lot more of them. It is a different approach for us. And I'd say that's also true where we've been placing software packages with Department of Defense for our fusion map. And I could go through FAA with respect to our belongs environmental air traffic approach lanes. So, we are moving to what I would call secondary, which were originally our phase two. but we've been taking things like the lawns for the FAA, and we're now actually having it deployed across Europe. And we're using it in places like Heathrow right now and other major cities across Europe. So, I will say that just because it looks like this road has, the federal government has slowed or not gone through right now, we've moved, we are taking, I'd say, two steps back, one over, and three or four steps forward. So I expect that to be much more productive and have some better growth rates here over the next year or two. But I would say the good news is it's only a small part of our revenue. In fact, the smallest of small. But the bad news is it has pushed us back, I would say, at least a year from what we expected to be at this point.

Mike | Analyst, National Bank Capital Markets:

Yeah, sure. No, that's very helpful. And maybe one quick one if I can squeeze in for Steve. In terms of, obviously, the balance sheet is extremely healthy and delivered. In terms of the desire to do anything more or off-size relative to your history, you might need to be providing some guardrails in terms of how we should be thinking about that. Thank you.

Steve Burdick | Chief Financial Officer:

Well, I think, you know, if you look over the Tetra Tech's history, You know, we've, our acquisitions have been kind of that medium size, you know, adds, you know, two, three, you know, 7% of revenue per year when you add them all up. But what you have noticed also over the last couple years is, you know, we have acquired other public companies that, you know, that were larger than normal, that took a bit more creative financing, regulatory approvals. And we brought them into Tetra Tech and turned them around, and, you know, they're performing at much better rates than they ever were as their own public companies. And those were on the, you know, much larger size, comparatively speaking. So I would say that our strategy and appetite is anywhere from, you know, the small to medium-sized companies to, you know, the larger companies. you know, public or private equity health companies that, and I believe that both with our current balance sheet, our current bank credit facilities, and the capital markets that are available to us, we have a lot of different choices with, at significant, bigger sizes than even RPS, which was our largest acquisition in the history of the company just, you know, three years ago.

Mike | Analyst, National Bank Capital Markets:

Okay, that's great. Thank you so much.

Melissa | Conference Call Operator:

Thank you. Our next question comes from the line of Michael Dudas with Vertical Research Partner. Please proceed with your question.

Michael Dudas | Analyst, Vertical Research Partners:

Good morning, gentlemen. Good morning. I guess a year and a half ago, we had your investor day in New York. How much has happened since then? And how much has happened since then? Just wanted to get maybe you can share a little reset. As you look after your 2030 targets, are more confident, less confident are you given all the disruption that you've witnessed and successfully overcome and started during fiscal year 2025? And as we think about that, Does, because of the way your balance sheet is and the opportunities, does acquisitions become a little bit more important to achieving those longer-term goals than maybe it would have been 18 months ago?

Dan Batrak | Chairman & Chief Executive Officer:

That's a great question. So, I can answer that question many different ways really since probably February of this year with the new administration coming in and with USAID actually being, you know, eliminated as a federal agency. And I've been even asked this directly as, do you regret having come out with those targets for 2030? And a nicer version of that is, do you want to do a reset and actually put your number, a different set of numbers up there? My comment is, well, I don't know if I should put a bigger numbers quite yet. But I will tell you that there's no doubt that it's been an interesting year. And what's the old adage, one of the Chinese proverbs, may we live in interesting times? This has been the most interesting of times. But what interesting times do get us, and I'll tell you one thing I'm so proud of the management team here at Tetra Tech and all of the employees that we've lived through in change, change represents opportunity. And for each door that's gotten closed, and one's been completely closed with aid. We didn't close the door. Someone closed it on us. I'll tell you, those same staff, have actually been able to find new opportunities or new windows that have opened. And the windows are actually larger than the doors that were closed. For instance, the margins that were there that was closed in aid has actually been opened. The windows that have been opened have new opportunities that have much higher embedded margin. In fact, double, even triple the numbers that we had. So, there was two numbers on the 2030 plan. One was the total growth. No doubt that's been impacted. I'll come back to that, which is top line. But the second was margin basis points. And Steve Burdick very eloquently presented how we were going to expand 50 basis points per year over the five years from that time of the presentation to 2030. I don't know. Someone else closing out USAID for us actually took us almost a 50 basis points jump on a baseline up. And then on top of that, we said we now look like we're going to grow more like So as far as the margin goes, I think it wasn't actually a headwind, it actually became a tailwind, and somebody gave us a boost up on that. Now, with respect to top line, no doubt, someone says if you just had $550 million subtract from you, and the rule of compounding is going to make that even more difficult on you, My comment would be that the rule of compounding only is going to hurt me if I don't actually close that gap in the next couple of years. And we only had a 4% to 5% contribution from M&A, or mergers and acquisitions. I'll focus on acquisitions, people joining us. Steve just went over, we have more , dry powder, which is access to capital. I'll comment that while you'd say if you go to market right now and you have excellent credit rating, you'll get 4%, 5%, 6% interest rates. Thanks to Steve's foresight, Tetra Tech has a 2% interest rate because the convert that we put in place a year and a half ago. So, we have the lowest cost of capital. We could actually do acquisitions at half again or double the 4% to 5% presented. in the 2030 plan that we presented in May of 2024. So we could do double that number and not actually go outside the range of one to two leverage that we've identified. So with respect to closing the gap that's just created, I don't see that as an issue. Yes, it means that we'll turn up our M&A a bit. But as my comments on an earlier question on this call is, are there actually firms available that, and as a price point, I think I answered that, I hope, in enough detail to say absolutely, and even at a better multiple. And by the way, someone who's going to join Tetra Tech isn't getting a lower multiple, they're getting a better home. And so I think that, yes, M&A will become a bigger part. And I think we can get to that number without having put any additional pressure on our organic growth targets, which is six to 10. I think you've seen even in this period of great turmoil or may live in interesting times, we're coming right out of the gate. We're right at the middle of that range organically at 8%. So, yes, M&A will have to be a bit larger, but I don't see financially or opportunity availability being an issue for that.

Melissa | Conference Call Operator:

Thank you. Ladies and gentlemen, that concludes our question and answer session. I'll turn the floor back to Mr. Batrak for closing comments.

Dan Batrak | Chairman & Chief Executive Officer:

Great. Thank you. Thank you very much, Melissa. And thank all of you for joining us on the call today. Thank you for being supporters of the company through all of fiscal year 2025. I'd like to reiterate that I could not be prouder of the performance of the Tetra Tech employees all around the world. and really how we navigated 2025. And I can't see a better demonstration of how that performance actually was other than the all-time records in nearly every field. As I just indicated, and this last question came, how's it looking with all the changes? I do think that there's more opportunities there for Tetra Tech, particularly in the market leadership positions we're in, to make 2026 just a fantastic year. And I really look forward to reporting back to all of you in roughly 90 days from now, or at the end of Q1, to report how we started out in fiscal year 2026. And with that, I hope you all have a safe and successful day today. I will likely not talk to you collectively before the holidays, so I hope you have a great holiday wherever you happen to be located. Thank you very much, and have a great week.

Melissa | Conference Call Operator:

Thank you. This concludes today's conference call. You may disconnect your lines at this time. Thank you for your participation.