NASDAQ:TTEK Q2 2026 Earnings Call Transcript

Generated on 11/25/2026

Christine | Conference Operator:

Good morning, and thank you for joining the Tetra Tech earnings call. As a reminder, Tetra Tech is also simulcasting this presentation with slides in the investor section of its website at tetratech.com. This call is being recorded at the request of Tetra Tech, and this broadcast is the copyrighted property of Tetra Tech. Any rebroadcast of this information in whole or part without the prior written permission of Tetra Tech is prohibited. With us today for management are Roger Argus, Chief Executive Officer and President, and Steve Burdick, Chief Financial Officer. They will provide a brief overview of the results and will then open the call for questions. I would like to direct your attention to the Safe Harbor Statement in today's presentation. Today's discussion contains forward-looking statements about future business and financial expectations. Actual results may differ significantly from those projected in today's forward-looking statements due to various risks and uncertainties, including the risks described in Tetra Tech's periodic reports filed with the SEC. Except as required by law, Tetra Tech undertakes no obligation to update its forward-looking statements. In addition, since management will be presenting some non-GAAP financial measures as references, the appropriate GAAP financial reconciliations are posted in the investor section of Tetra Tech's website. At this time, I would like to inform you that all participants are in a listen-only mode. At the request of the company, we will open the conference for questions and answers after the presentation. With that, I would now like to turn the call over to Roger Argus. Please go ahead, Mr. Argus.

Roger Argus | Chief Executive Officer & President:

Thank you, Christine. Good morning, and welcome to our Fiscal Year 2026 Second Quarter Earnings Conference Call. I'm pleased to join you today for my first quarterly call as CEO of Tetra Tech. I want to begin by recognizing Dan Batrack's leadership for more than two decades. Dan and I have worked together for many years, and I'm grateful for his continued partnership and support as our executive chairman. Tetra Tech's success is made possible by our 25,000 employees around the world. I've had the privilege of working with many of our technical teams across our operations. Their expertise, client commitment, and ability to solve complex problems are what make Tetra Tech different. Demand for clean water, environmental quality, and resilient infrastructure continues to grow worldwide. Our strategy is not changing. We will continue to focus on high-end solutions that address the complex challenges where our clients need us most. To call today, I will begin with an overview of our second quarter's performance and the client markets that are driving our growth. Steve Burdick, our Chief Financial Officer, will provide additional detail on our financial performance and capital allocations. We delivered a strong second quarter with positive performance across our key financial metrics. Net revenue increased by 8% during the quarter on a year-over-year basis, supported by demand for our high-end consulting services in water, environment, and sustainable infrastructure. EBITDA of $146 million resulted in a margin expansion of 90 basis points when compared to last year and is an all-time record for our second quarter. Earnings per share were $0.36, including $0.02 associated with the completion of the divestiture of our Norwegian operations. Our adjusted earnings per share of $0.34 exceeded the high end of our guidance and was also the highest for any second quarter. And importantly, our backlog increased by 8% sequentially and is now $4.28 billion, which illustrates the resiliency of our technically differentiated leading with science approach. Overall, the quarter demonstrated the strength of our business model. We are growing in the right markets, improving margins, and entering the second half of the fiscal year with strong momentum. I would now like to discuss our performance by segment. The Government Services Group, or GSG, grew 5% in the second quarter on a year-over-year basis and generated a margin of 16.3%, up 220 basis points from last year. Demand remains solid for our water, environment, defense, and resilient infrastructure services. The Commercial International Group, or CIG, also

performed well with revenue up 10% from the prior year and a margin of 12.2%. CIG's diversified mix of clients across water, environmental, power, and energy markets worldwide provided growth across the key geographies that we work in. I would now like to provide an overview of our net revenue by customer. Our U.S. federal work was up 11% last year and represented 20% of our business. This growth was driven by our work with the U.S. Army Corps of Engineers for resilient infrastructure, including flood protection and inland navigation, defense facility systems modernization, and major planning and programs for defense. Our U.S. state and local business grew 9% this quarter on a year-over-year basis and represented 14% of our business. Growth was driven by municipal water projects, primarily in the high priority regions of Florida, Texas, California, and Virginia. Our U.S. commercial business represented 19% of our business and was down 2% compared to last year. We did see a significant increase in revenues for energy and transmission related services. However, this growth was offset by a reduction in renewable energy services, especially associated with the wind down of the large offshore wind programs we worked on last year. Our international work was up 12% on a year over year basis. Driven by revenue growth in water services in the UK, Ireland and the Netherlands. An increase in infrastructure services in Canada, and growth in the digital automation revenues in Australia. I would now like to discuss our backlog. We had a strong quarter for new orders and our backlog increased 8% sequentially. This is an important indicator of our increased demand for our services. As we've stated before, we take a conservative approach to backlog. We include only work that is contracted, funded, and authorized. This gives us high quality visibility into future performance and increases our confidence in our project pipeline. Our backlog growth was supported by several important wins across our priority markets. In the United States, we added more than $650 million in contract capacity from U.S. defense clients for water and resilient infrastructure services. These projects support critical infrastructure needs that align directly with our strengths in water, environmental services, engineering design and digital systems. In Northern Ireland, we added a new 18 million British pound single award contract for water and wastewater treatment services. In the Netherlands, we added a framework contract that significantly expands our capacity in key regions with planned investments to address essential flood protection and infrastructure modernization needs. At the Port of Los Angeles, we were awarded a master service agreement that supports one of the most important trade and logistics gateways in the United States. And finally, we further expanded high-end solutions for United Utilities in the UK with our WaterNet software that provides a comprehensive platform for managing priority water leakage detection and water delivery modernization needs. I will now turn the call over to Steve Burdick, our Chief Financial Officer, to discuss our financial results and capital allocation in more detail.

Steve Burdick | Chief Financial Officer:

Steve? Well, hey, thank you, Roger. I would like to now provide an update on our reported year-to-date fiscal 2026 results, working capital, cash flows, and capital allocation. So as Roger just discussed in 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 reported revenue was down from last year due primarily to the decrease in revenue from USAID customers and revenues from one-time disasters this year compared to last year, our operating income increased significantly and adjusted EBITDA on net revenue for the quarter year to date increased by 110 basis points to 14% for the first half of fiscal 2026. These results further support our long-term strategic goals in improving EBITDA margins by 50 basis points annually. As a result of our ability to enhance our profit margins and further manage our working capital, we were able to increase EPS over last year and come in well above our previous guidance range for the second quarter. Now, regarding our working capital, Cash flows generated from operations for the first half of the year were a historical record at $238 million, which represents a significant improvement over fiscal 2025. And consistent with the last 20 plus years, our operating cash flows have continued to exceed net income. Our focus on working capital and cash flows has resulted in our DSO reflecting an industry-leading standard of 58 days which is a nine-day improvement compared to Q2 of last year. This lower DSO metric provides a significant insight into our core business as it reflects 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, it amounted to about $657 million, and the net debt on EBITDA was at a leverage of 1.0 times, which is about, which is a little over 25% lower than our leverage ratio one year ago when it stood at 1.36 times. As we continue to execute on high-quality operating results with increasing margins, our operating cash flows in excess of net income and lower working capital KPIs, we will continue to provide higher returns for shareholders. And those higher shareholder financial returns are reflected in an improving return on capital employed, which now stands at over 20%. So with that perspective, I would like to now present our capital allocation strategy and overview. We have a very strong balance sheet, probably the strongest balance sheet in our history, and are offering cash flow with $688 million for the trailing 12-month period. Now, Roger will discuss our strategic growth areas later in this presentation, but I do want to point out that our balance sheet and cash flows provide us with significant liquidity available to invest in organic and inquisitive growth priorities in order to take advantage of these key business opportunities. which includes technology and automation, which also continues to provide us a dominant position in those markets. And during the second quarter and third quarter to date, we have closed the acquisitions of technical leaders focused on defense, such as Halvik in the US and Providence in Australia. And regarding our dividend program, I'm pleased to announce that our Board of Directors approved the quarterly cash dividend which is an 11% increase year over year to be paid in third quarter. This is the 44th consecutive quarterly dividend with annual double digit increases in the amounts to be paid. And based on the lower leverage, we've continued our stock buyback program this year. And in the first half of 2026, we bought back a total of $100M. We do have $498 million available from the stock buyback plan approved by our board as part of our capital allocation strategy. So I'm pleased to share these really strong results for the start of fiscal 2026, which has enabled us to increase shareholder returns as we can pay increasing dividends, increase our stock buybacks, engage in accretive acquisitions, all the while deleveraging our balance sheets. I want to thank you for your support, and I will now hand the call back over to Roger to discuss Tetra Tech's growth opportunities for 26 and beyond.

Roger Argus | Chief Executive Officer & President:

Thank you, Steve. I would now like to provide an update for our outlook for the second half of fiscal year. We are beginning the third quarter with strong backlog and clear growth opportunities across our markets. As a result, we are increasing our forecasted growth rates for the second half of the year for both our U.S. federal and U.S. commercial client sectors to 8 to 12 percent. Together, these sectors represent 40 percent of our revenues. We expect U.S. federal to increase as our clients deploy funding to address both domestic civil works programs and defense facility modernization globally. U.S. commercials increased growth rates aligned with the expected demand for water management for mining operations, expansion of domestic rare earths mine development, and further acceleration of the upfront work of planning and permitting for power generation and transmission. International work, we expect to grow at a 5 to 10% rate with continued strength in the United Kingdom, Ireland, the Netherlands water. and expected marine defense infrastructure spending in the UK and Australia. State and local work is expected to be about 15% of our business, with a growth rate in the high single digits between 5 and 10%. Our long-term outlook remains strong, with state and local spending increasing regionally in alignment with demand. I'll now discuss our US commercial, US defense, and US state and local municipal water business each in a bit more detail. Our U.S. commercial business is being driven by growth in power, data centers and transmission. Electricity demand in the United States is expected to grow significantly over the next decade. Utilities and energy developers are responding by expanding and diversifying energy sources. We are ranked number one by engineering news record in the U.S. environmental work and have supported over 6000 energy related permitting studies. New transmission corridors and upgrades are also needed to connect power generation with fast growing demand centers. These projects often cross multiple jurisdictions, which create complex planning and environmental requirements. We have permitting experience in all 50 states and bring experience from over 10,000 miles of transmission projects. At the same time, data centers further increase demand for water and power. Across the U.S., we are seeing examples of community resistance to data centers, and over 15 states are considering restrictions to data centers. Petri Tech's front-end feasibility expertise is increasingly valuable for

data center developers. Clients need clear answers on water availability, power sourcing, environmental constraints, permitting risk, and scheduling implications. For data centers, we currently have more than 20 active feasibility assessments for developers and providers at the earliest stage of their projects, supported by multidisciplinary multidisciplinary community of planning, water, environmental, and power subject matter experts. For our U.S. federal business, the large budget increases and heightened priority of defense is expanding our opportunities to provide resilient infrastructure and planning services. In the U.S., we have federal contract capacity of $30 billion, with coverage across defense agencies and locations domestically, and for facilities the U.S. has placed around the world. For the Army Corps Civil Works Program, we design critical water infrastructure, including flood protection, dams and reservoirs, and navigation systems. For the U.S. Navy, we similarly provide planning, permitting, and design services for the modernization of their specialized marine facilities. And for the U.S. Air Force, we also provide the specialized expertise to transition to new firefighting foam technologies and apply our PFAS grub technology to remove remaining legacy PFAS contaminants. Our state and local business, where we hold contracts with over 500 municipalities, remains a strong and stable growth driver for our business. Across the U.S., we are working with our clients on the early stages of more than $30 billion in capital spending. We are helping our U.S. municipal water clients to mitigate droughts by adding new water supplies that require the design of advanced treatment solutions. In low-lying coastal regions affected by saltwater intrusion, including high-population areas of Florida, we designed specialized solutions to inject treated water into groundwater. In the near term, municipal clients are anticipating less reliance on supplemental federal grants by adding new funding resources. They are increasing rates, issuing bonds, and restructuring funding to move their essential water projects forward. States such as California, Texas and Florida and others are stepping up and issuing new funding to support their local water utilities. With strong demand for sustainable water supplies, we expect to see continued growth and significant opportunities to address the regional water challenges in the major California, Texas and Florida markets, as well as in the expanding population centers in coastal regions such as Virginia and in the drought affected areas in Colorado. I'd now like to present our guidance for the third quarter and the entire 2026 fiscal year. Our guidance is as follows. For the third quarter, net revenue guidance is from 1.05 to 1.1 billion. Adjusted earnings per share guidance is from 38 to 41 cents. And for the fiscal year 2026, Our increased net revenue guidance is from 4.25 to 4.4 billion, and our increased adjusted earnings per share guidance is from $1.50 to $1.58. The right side of this slide represents the FY26 net revenue growth, which is up 9% year over year at the midpoint, with an associated margin expansion of 70 basis points year over year at the midpoint. You can read the FY26 assumptions, but I'll highlight a few. Intangible amortization of $33 million, depreciation of $24 million, interest expense of $33 million, and a steady effective tax rate of 27.5%. And this guidance does not include contributions from future acquisitions. In summary, we had a strong second quarter and first half of FY26. Our operations continue to generate record cash. Demand for Tetra Tech's differentiated leading with science services in water, environment, and consulting continue to drive our growth as exemplified by the sequential increase in our backlog and significant wins with defense agencies. Our high-end technical services are well aligned with long-term demand in the United States and internationally. And with our increased confidence, we have raised our guidance for the full fiscal year to 26. I think we'll now open it up for Q&A.

Christine | Conference Operator:

The question and answer session will begin now. 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 your 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 then 1 on your touchtone phone. One moment, please, while we poll for questions. Thank you. Our first question comes from the line of Tim Mulrooney with William Blair. Please proceed with your question.

Tim Mulrooney | Analyst, William Blair:

Yes, good morning. Thank you for taking my questions. I had a few questions on backlog to start off. I see it was up 8% sequentially. I'm curious if you expect to build on that momentum as you move through the year and crucially what the margin profile of the backlog looks like.

Roger Argus | Chief Executive Officer & President:

Good morning, Tim, and thank you for the question. It's a good one. On our last quarterly earnings call, we noted that we expected that once the US federal budget was resolved, we might see influx of new orders or release of new orders. So the budget was largely resolved in early Q2. And as expected, we saw new orders increase from the US federal government. These orders included task orders from from defense, including U.S. Army Corps, Naval Facilities Engineering Command, U.S. Air Force Civil Engineering Corps, and other federal clients as well. And as I mentioned in my prepared remarks, we've seen an increase in our defense contract capacity by $650 million just in Q2. We're starting to see task orders under those contracts. Additionally, we received work under our contracts with UK with United Utilities and others from well-supported programs under the AMP8 program, as well as new awards in Northern Ireland. And collectively, these resulted in an 8% sequential growth, which gives us great visibility into Q3 and Q4 as we convert the backlog into revenue. I believe that Q2 represents an inflection point for Tetra Tech in terms of our backlog. And we do expect to see continued growth based on new orders through the rest of the fiscal year. So, the backlog is consistent with the growth rates reflected in our forecast with the second half that I presented and also support continued margin expansion, you know, I would say in line with what we've been experiencing the last couple of years.

Tim Mulrooney | Analyst, William Blair:

Okay, that's really helpful. Thank you, Roger. I also wanted to ask a question about your international business. I heard you talking a lot about the water opportunities in the UK and Ireland and, you know, the increased spending in some areas in Australia. But I wanted to ask about Canada because, you know, we recently saw the Canadian government announce more than 40 billion for development to the northern and the Arctic regions for new forward operating locations, radar systems, other hubs. And I know you guys do a lot of front end work for infrastructure development. So I was curious how you're thinking about this opportunity over the next few years.

Roger Argus | Chief Executive Officer & President:

Yeah, we're actually quite excited about the opportunity that that new funding presents. I do think it is early days, but we are positioning for opportunities for export terminals and marine facilities on the east and west coast, as well as build out of the the Northwest Passage for ports and harbors related to not just military use, but also potentially commercial use as well. So for us, our expertise in coastal resiliency, marine facility design, planning, permitting are really well suited on the east and west coast. And then we have very specialized capabilities and experience in working with the Arctic and designing roads and facilities in that extreme weather circumstance. We're quite excited about it. Now, in terms of timing, I would just caution that it is early days. And, you know, there have been some strong announcements. And there is tremendous growth potential there. But it is early days. So I don't see this as something that's going to impact us in FY26.

Tim Mulrooney | Analyst, William Blair:

Got it. Well, something to look forward to in future periods. And thank you for the color.

Unknown Participant:

Welcome.

Roger Argus | Chief Executive Officer & President:

I think the resolution of the federal budget, which isn't completely resolved, but the area that's not resolved doesn't really affect our work. But that's very helpful for our clients in terms of visibility for funding for their programs. which has fueled the uptick in backlog that we've seen. And we don't anticipate any government shutdown the rest of this fiscal year, so we see that momentum continuing into Q3 and Q4. And, you know, I talked about a number of the other drivers in the non-federal space as well, power, water, data centers, So the drivers there are very strong in all of our end markets. And so we expect to see continued growth in backlog and associated, you know, conversion of that backlog to revenue to drive our results through the rest of the year.

Unknown Analyst | Analyst:

Great. And then particularly as we sort of think about some of your markets outside of the U.S., you know, having said that, seeing some of the clarity on the US side, how are you finding the demand backdrop or just a macro view in some of your international markets, whether it's the UK, Australia, et cetera, you know, has the demand trends or the demand outlook there followed some of the macro headlines or has it been more driven by local needs and markets such as water and understand the outlook on demand outside of the US based on the current backdrop?

Roger Argus | Chief Executive Officer & President:

Yeah, I think it's a bit of both actually. I mean, the global, geopolitical situation affects all of the geographies that we work in. However, there are local demands for water and power and other items that drive our services as well. And in the UK, for example, you know, AMP 8, as we've reported before, has received double the funding from AMP 7, and we continue to see growth in our water services that are funded. through that program to the utilities that we work with across the UK. As I reported in my prepared remarks, new projects and awards in Northern Ireland, which continues to fuel growth there based on a variety of demands. We talked a bit about Canada with new infrastructure funding. There's a lot of activity and potential opportunity in Canada. You know, it's interesting that the U.S. policy of sort of America first or maybe even America only is fueling work and investment in some of the other geographies we're working with, most notably Canada. You know, development of export terminals and the northern front and all of that is in part in response to U.S. policies, I think. So we're very excited about continued growth there. And in Australia, price of gold is still hovering near $5,000 an ounce. And so we see increased mining activities there. For us, Australia has been kind of an interesting story because post-COVID, there was a bubble of infrastructure investment to really get everyone back to work in the country. And so we've seen a bit of a decline as that work burned off. But we're starting to see, I guess, green shoots in terms of new infrastructure spending. Obviously, mining is fueling activity and projects for us. Defense with some of the shore facilities is driving growth for us. And we're even seeing opportunities with the new infrastructure spending, including for the 2032 Olympics in Brisbane. So we're excited about Australia coming back for us.

Unknown Analyst | Analyst:

Great. And then just one last quick one on the capital allocation. Steve, I think you noticed or noted there's flexibility there, whether it's on dividends, buybacks. Given where the share price is today, the M&A opportunities ahead, maybe a bit more granularity on how you're sort of prioritizing some of the opportunities, given that the balance sheet is getting to a pretty flexible level. Thanks, and I'll pass the line.

Steve Burdick | Chief Financial Officer:

Yeah. So I would say that as we look at our different opportunities to grow through acquisitions, we do look at the totality of our balance sheet and our leverage and the dry powder we have available through multiple sources of capital borrowing from banks or others. You mentioned equity. We've never used our equity, but that's to do any acquisitions, but that doesn't mean that it's off the table either. So I think between our balance sheet and the equity that we have in our shares, I think we have the opportunity to really invest in the growth areas that we think are going to have the most value for the company and our shareholders over the next couple of years.

Unknown Participant:

Thanks very much.

Christine | Conference Operator:

Our next question comes from the line of Sangita Jain with KeyBank. Please proceed with your question. Thank you for taking my question.

Sangita Jain | Analyst, KeyBank:

So can I ask one on the cash flow strength? And now that the business has kind of recalibrated post-USAID Maybe if you can help us understand how much further room you think you have on DSO reduction to keep up with this cash flow strength.

Steve Burdick | Chief Financial Officer:

Yeah, I think as we continue to make improvements in our system, as we continue to really enhance how we, you know, go to market with our clients, I think you've seen over the last, you know, we can go back 10 years, but you can go back, you know, four or five years, you've seen a continual improvement in our DSO year over year. And, you know, now that our DSO is hovering in the mid-50s, I think we have the ability to, you know, take that down to, you know, closer to 50 days. I will tell you that our goal is to, you know, continue to see that improvement. I think, you know, one thing to understand that, as we talked about prior, as, you know, our fixed price contracts not only provide us higher margins, but they also provide us, you know, a lower DSO in our working capital. I think as we continue that mix in our projects towards more fixed price work, I think we'll have the ability to also bring our DSO down over the next couple of years.

Sangita Jain | Analyst, KeyBank:

Great. Thank you. And then can I ask one on data centers? Can you tell us exactly what work you're doing for them and how your scope is evolving with time as the data centers get bigger?

Roger Argus | Chief Executive Officer & President:

Well, for us, our primary work we're doing for data centers, as I explained in my remarks, is feasibility associated with siting. You know, there was a lot of press releases, announcements of large investments. I think developers started to move forward and then began facing community resistance and concerns around the impacts of a data center in their neighborhood, if you will. What would the effect be on water availability and rates? What would be the effect on power? What would be the effect on environmental conditions, et cetera? So what we've seen is the developers coming to us because those services are really in our wheelhouse to address these concerns and do feasibility studies that address power considerations and availability, water availability, local regulation, community input, permitting, all of these things. So these are all core competencies within Tetra Tech that we offer in a variety of end markets. And so we see that work. We also do some work within the envelope, SCADA systems, commissioning, other type of high-end engineering work associated with data centers. But the predominance of the work right now is really really in the most upfront feasibility studies in supporting siting, permitting, and locating the data centers.

Christine | Conference Operator:

Great. Thank you so much. Our next question comes from the line of Ryan Connors with North Coast Research. Please proceed with your question.

Ryan Connors | Analyst, North Coast Research:

Good morning. I appreciate all the details. It's been very comprehensive, but I do have a couple questions. Roger, you laid out the market outlook by market, which was very helpful. But just to kind of probe on that a little bit, you did lower the outlook for state and local to 5 to 10 from 10 to 15%. And you had some comments around municipalities sort of shifting from federal to local funding. Can you just expand on that? Seems like a notable shift from three months ago. and sort of how that impacts your strategy to really lean harder into that market.

Roger Argus | Chief Executive Officer & President:

Right. So the municipal water market for us has been one of the staples and strategy growth areas for Tetra Tech for many, many years. And what I mentioned I think really indicates caution from our clients related to the proposed federal Budgets for next year, which include some potential reductions in in supplemental grant funding. So, for the most part, our projects don't rely on, like, money and this kind of thing. Some of the projects are clients depend on some of the Co funding. So what our clients have done is in an abundance of caution are looking at alternative methods to keep their projects moving forward. So that's what I was referring to in the prepared remarks. We still see the market growing and you know, in our projects moving forward. But our clients are having to sort of reconsider to make sure that they've got funding for all the things that they want to do. And that's just, I'd say, one factor in us lowering that range. The other, I was actually going to ask Steve to comment on a little bit, which is we've been growing at a high rate and compounding for many years. And Steve, let me let you address that part of it.

Steve Burdick | Chief Financial Officer:

Yeah. So as just as a point of reference, you know, back in, 2024, our state and local work on a net revenue basis was about 11% of our total net revenue. We grew that to about 14% last year in fiscal 2025. And this year it's right around that same 14%-ish, 14, 15%. So I think the growth that we're seeing pretty close to the same dollars that we've seen over the last couple of years, but it's just on a higher base. So that's where you see that percentage decrease a little bit for the reasons that Roger pointed out.

Ryan Connors | Analyst, North Coast Research:

Got it. Okay. And then thinking through, you talked earlier about the budget dynamics on the federal side, which obviously this is where it relates to what goes on in state and local, but a lot of posturing. I know we had a pretty fiery hearing yesterday where EPA commissioner was out there making some pretty hyperbole around the budget cuts to EPA and so forth. How do we look at that? Obviously, we have midterms coming up. Are the midterms really going to be a crucial factor in ultimately how we look at calendar 27 in terms of how that shapes up the next couple of years?

Roger Argus | Chief Executive Officer & President:

It's a great question. And I'd say our visibility into funding and federal funding in FY26 is a little limited. We've seen an initial budget from the White House, but it's subject to a lot of debate and compromise probably in Congress, especially in light of midterms. What we saw last year was a similar, I would call it, very aggressive budget from the White House, which was then muted and mitigated Patrick Corbett- Through the discussions and ultimately the budget being awarded I think it was February 4 of this year, it took quite a long time so it's really difficult to speculate, I will say that we do see strength in our end markets. Patrick Corbett- You mentioned EPA, for example, the type of work that we do for EPA is typically associated with the super fund program which includes long term obligations for. you know, cleanup and assessment and all the associated activities. Historically, those have been immune to budget cuts because there are, you know, legal responsibilities that need to be fulfilled there. So we've seen, again, strong resilience of our end markets in the federal space that might be affected. But it's really too early to comment on where the FY27 budget might end up and what the implications might be.

Ryan Connors | Analyst, North Coast Research:

Got it. And then I apologize for a third one, but I did just want to get your take on the Iran conflict geopolitics from the standpoint of opportunity. Obviously, it's a water scarce region. In the past, we might have thought about USAID would be involved and there would be some kind of opportunity there for Tetra Tech on the back end of that, you know, rebuilding efforts and the like. Is that still the case through other departments, like the State Department, things like that? Or is that something that's just not going to be a story going forward with the USAID off the books?

Roger Argus | Chief Executive Officer & President:

Well, I think the opportunity for us in the Mid-East in a post-war scenario has to do with the U.S. Army Corps of Engineers. It's really rebuilding damaged facilities. Over the years, in the past, supporting predominantly the U.S. Army Corps of Engineers, we've supported foreign military sales and other facility development in the Middle East, including bed down areas, hangars, all sorts of other infrastructure and facilities. So a host conflict opportunity for us would be those types of opportunities. We still have those contracts with the U.S. Army Corps Middle East District, and so we're obviously pre-positioning as best we can for post-conflict opportunities. So it does present an opportunity, but not maybe in the way that you might have suggested in

your comment, your question.

Ryan Connors | Analyst, North Coast Research:

Yep. Very helpful. Thanks for your time. Thank you.

Christine | Conference Operator:

Our next question comes from the line of Maxim Sitkov with National Bank. Please proceed with your question.

Unknown Participant:

Hi. Good morning, gentlemen. I wanted to go back to your comment around the fixed price exposure, because I think it's up almost 900 basis points kind of year on year. And obviously, we're also seeing pretty significant margin improvements over the time frame. Can you maybe talk a little bit about that sort of algorithm as that, you know, sort of both percentages are going higher? And how would you be thinking about the ultimate momentum for both? Thank you.

Steve Burdick | Chief Financial Officer:

Yeah. So I'll give you, you know, just maybe a historical perspective on, you know, how we've progressed our fixed price work, you know, back in 2023. So, you know, our fixed price work represented about 37% of our total net revenue. So far, year to date, that is about 48%. And so, you know, with that increase in our fixed price work and the kind of fixed price work that we do, you know, we've seen our margins increase over that same time period. I think the other thing, too, you did particularly see that in our GSG margins year over year from the standpoint that, you know, last year, the fixed price work represented about 29% of our revenue or net revenue in GSG last year. This year it's about 42%. And as Roger pointed out earlier in the presentation, we saw a significant increase in our margins. So I think our goal is to continue to focus on progressing our contract types more heavily weighted towards fixed price work. And based on our history, like I said, talked about earlier, our fixed price work does carry higher margins and it does carry lower working capital requirements. So we believe that, you know, that will be a financial benefit and a value benefit on a go-forward basis.

Unknown Participant:

Super helpful. Thank you. And then I had another, I guess, more of a probably philosophical question around capital allocation and M&A. I mean, if we go back maybe three years ago, like large scale M&A was viewed as a kind of net positive for most industry players. Right now, given sort of the new technological developments, I think there was probably a bigger question mark from investors. I'm just wondering where do you land kind of on that spectrum in terms of where to deploy capital in case for M&A? Thank you.

Roger Argus | Chief Executive Officer & President:

Well, why don't I start and then Steve can kind of chime in. I think for Tetra Tech, we've always been very disciplined in terms of how we approach M&A in terms of strategic fit, financial creativeness. You know, you bring up a really good point that in today's world, we've seen impacts from a variety of sources that create uncertainty. And so I think for us, M&A is about fit. and timing. So I think that's sort of the philosophical

response is finding the right time when a deal becomes advantageous to our shareholders. So, you know, Steve, you wanted to add?

Steve Burdick | Chief Financial Officer:

Yeah, I think, you know, our priorities are really, you know, looking at advanced analytics in terms of water, you know, digital automation in areas where, you know, we want to increase our, you know, touch points with clients, improve the technology that we can provide our clients and in areas that, you know, will help us be a market leader in all of those different geographies where we compete.

Unknown Participant:

Excellent, Carlos. Thank you so much.

Christine | Conference Operator:

Our next question comes from the line of Andrew Whitman with Baird. Please proceed with your question.

Michael Dudas | Analyst, Vertical Research Partners:

Hey, good morning, and thanks, guys, for taking my questions. I think my first question has to do with the backlog versus the revenue expectation. And after USAID went away, since, you know, after that quarter, your backlog ex-USAID is up about 2%, but your kind of underlying growth rate's a little higher than that in the forecast, at least from the back end of the year. And I was just wondering, Steve, a few comments. You seem like the average duration of the backlog shortened. I think you May have mentioned some of these comments kind of over the last couple of quarters on the federal side, but I was just wondering, generally speaking, if that's kind of the mechanism at play there, if there's something else going on.

Steve Burdick | Chief Financial Officer:

No, I would I would say that with, you know, with the. I'll call it backlog decrease from USAID, which did have longer term backlog for sure over several years. And with the, you know, with the different federal agencies just starting to ramp back up, as Roger said, you know, getting some clarity in early February, you know, a lot of the backlog is continuing to be, you know, fairly shorter term compared to some of the prior years. And so, you know, we do see still a bit more book and burn.

Michael Dudas | Analyst, Vertical Research Partners:

um this year versus uh maybe uh and in prior years but um yeah so that's that's probably the key driver in terms of them uh here to address your question okay great thank you for that and then just kind of two other kind of punch list questions here for you Steve to just understand the quarter a little bit better um first um what was the FX impact uh to net revenue for the quarter as well as can you just comment on, I don't think there was any disaster in the quarter, but maybe you could confirm that. And then just talk about, obviously, the appendix shows the $61 million net revenue from Ukraine in the quarter. Just wondering what your thought is for Ukraine on the back half of the year, if there's anything included in the guide, and if there's any change in the guide related to Ukraine as a result of seeing another actually very good quarter of revenue from that. So just those. Thank you.

Steve Burdick | Chief Financial Officer:

Yeah, so kind of in order, the FX impact was, you know, fairly minimal, not really that material. So, you know, we didn't feel the need to call that out, especially compared to, you know, where we provided guidance and then kind of what those estimates were. So really kind of in line with that. I would say that for the disaster work, There was effectively, there was none, there was no 1 time disaster revenue that, you know, unlike last year where we had several of the largest hurricanes in Florida, and then the fires in Southern California. So this last quarter, there was none of that revenue. And then you're right in the, in the appendix. We did have about 61Million dollars in, you know, USAID work that was primarily related to increased activity in Ukraine. And for the rest of the year, we have about $20 million per quarter for both Q3 and Q4 in our guidance estimates right now.

Michael Dudas | Analyst, Vertical Research Partners:

Okay, great. Thanks very much, and have a good day. Thanks. Thank you.

Christine | Conference Operator:

Our next question comes from the line of Kate Sullivan with Maxim Group. Please proceed with your question.

Kate Sullivan | Analyst, Maxim Group:

Hi. Thank you very much. Looking at the commercial CIG operating income margin versus GSG margin and understanding there's some acquisition impacts in the margin for the fiscal second quarter, do you still expect that the CIG margin may approach closer to the GSG margin level, or is that a changing dynamic, please?

Roger Argus | Chief Executive Officer & President:

I'll start and then Steve could actually comment further on this. I mean, for us, Q2 is probably the weakest quarter for CIG because of, you know, a lot of the geographies that we support through that segment are in the northern hemisphere, the very northern hemisphere. So, in the wintertime, we tend to have, you know, lower utilization, et cetera, because there's no field work. And then, you know, Australia, you have a lot of holidays and vacations. So it's kind of a seasonal effect. And I think this year was maybe a little more than what we would have expected. However, we do expect through the balance of the year for the CIG margins to improve and come back to normal levels. Steve, do you want to?

Steve Burdick | Chief Financial Officer:

Yeah, no, I agree with Roger. I think when you look at the projects and the revenue that are in our backlog, We can see the increased margins, you know, primarily in CIG more so than in GSG. So we do see those two getting closer together.

Kate Sullivan | Analyst, Maxim Group:

Okay. And last for me is the port of LA work. You called it out in the backlog slide. You had a press release at the end of March about it. Was it a meaningful contributor to the backlog increase, or are you doing much more in the Port of L.A. in the next three years compared to batches of the three years historically?

Roger Argus | Chief Executive Officer & President:

Well, the Port of L.A. has been a long-term client for us, so we're excited about the renewal of the MSA, and we expect to continue to do work and grow that portfolio. So, yeah, it's impactful for us. In terms of size compared to the total corporation, it may not be material, but it's exciting for us to continue that work. And we feel like it's one of the premier ports in the U.S. and illustrates our capabilities and differentiated services that we get selected for a prestige opportunity like that.

Kate Sullivan | Analyst, Maxim Group:

Thank you very much.

Christine | Conference Operator:

Our next question comes from the line of Michael Dudas with Vertical Research Partners. Please proceed with your question. Michael Dudas, your line is live. This will conclude the Q&A session. I will now turn the conference back over to Roger Argos to conclude.

Roger Argus | Chief Executive Officer & President:

Thank you, Christine. In closing, I'd like to thank everyone for your insight, questions, and interest in Tetra Tech. Tetra Tech's addressing our clients' most complex challenges in water, environment, and sustainable infrastructure using our leading with science approach. As CEO, my focus is to build on the foundation that has made Tetra Tech successful. I look forward to speaking with you again next quarter, and have a great day. Goodbye.

Christine | Conference Operator:

Ladies and gentlemen, this concludes our conference for today. Thank you all for participating, and have a nice day. All parties may disconnect now.