

# ECOLOGY AND ENVIRONMENT INC EEI

May 11, 2017 - 7:45pm EST

by

andreas947

|                      |       |          | 2017 | 2018 |
|----------------------|-------|----------|------|------|
| Price:               | 10.50 | EPS      | 0    | 0    |
| Shares Out. (in M):  | 4     | P/E      | 0    | 0    |
| Market Cap (in \$M): | 46    | P/FCF    | 7    | 6    |
| Net Debt (in \$M):   | -12   | EBIT     | 0    | 0    |
| TEV (\$):            | 34    | TEV/EBIT | 0    | 0    |

## Description

### Ecology and Environment, Inc. (EEI)

#### Summary

We focus on smaller companies with "Ft. Knox" balance sheets and large & sustainable free cash flow yields and we are typically seeking a double-digit FCF yield or higher on an unleveraged basis. The objective is for the sustainable FCF to eventually drive up the share price to a more reasonable valuation, through share buybacks, debt reductions, dividends, or accretive acquisitions.

Obviously, it is important we have a management team that cares about shareholder value. We also focus on small and micro-cap stocks because there is a much better chance to find an attractive investment opportunity which is under-followed or undiscovered.

Ecology and Environment, Inc. (EEI) is an environmental consulting firm and provides professional services to government and private customers worldwide. **EEI is a small company with limited trading volumes and likely most appropriate for either small funds or PA accounts.** EEI offers support services for response and site assessment activities related to the release and threat of release of oil, petroleum products, hazardous substances, and weapons of destruction or pollutants or contaminants. The Company also undertakes task order contracts comprising oversight of pollution remediation and hazardous waste remediation activities, as well as prepares environmental impact documents for federal land management agencies. EEI has about 735 full-time employees with 36 regional offices in the U.S. and 11 foreign offices. Revenues are derived primarily from the professional and technical services performed by its employees or, in certain cases, subcontractors engaged to perform on under EEI's contracts.

The Company's staff is comprised of individuals representing more than 80 scientific, engineering, health, and social disciplines working to provide innovative environmental solutions. The Company has completed thousands of projects for a wide variety of clients in more than 120 countries around the world, providing environmental solutions in nearly every ecosystem on the planet.

EEI's customers are a diverse group of commercial businesses and local, state, and federal agencies. The customer base is highly diversified. Revenues from international operations were 30% of total revenues in fiscal year 2015 and 22% in fiscal year 2016.

International operations are primarily in South American countries of Brazil, Peru, and Chile. Government work is a significant portion of total revenues for the Company - municipal, state, and federal government work together represented 24%, 27%, and 36% of total revenues in fiscal years 2014, 2015, and 2016.

Prior to fiscal 2014, under a previous management team, EEI over-expanded into geographic markets and business segments where

it did not have a strong competitive position. This resulted in large losses and the write-off of large receivables in the Middle East. Adjusted EBITDA declined from \$14m in fiscal 2011 to \$1m in fiscal 2013. In August 2013, Gerald Strobel, one of the Company's founders, took over as CEO and in January 2015 Gerard Gallagher, a long-time EEI executive, was appointed President of U.S. operations. In April 2015, Gerald Gallagher was made CEO. The new team focused on exiting unprofitable foreign markets in the Middle East and Africa, reducing the cost structure, exiting unprofitable business segments (e.g., asbestos remediation) and adding capabilities with stronger demand. A large portion of EEI's consulting work is linked to mining and energy development and these areas have been weak in recent years, especially in South America where EEI's revenues and pre-tax profits dropped sharply in fiscal 2016.

EEI has an attractive asset-light business model with limited capital expenditures and working capital needs and EEI generates strong free cash flows. EEI has a return on invested capital or ROIC close to 25% based on EBIT (\$5m) divided by net working capital (\$20m) plus net PPE (\$5m). The Company has been a strong and consistent generator of FCF for many years – in the five years from fiscal years 2012 to 2016, EEI generated about \$32m of cumulative cash from operations or about 100% of the current enterprise value (EV). Over this period, capital expenditures have averaged less than \$1m per year.

EEI has a "Ft. Knox" balance sheet, with \$12m in net cash at Q1 2017 ended January 31. EEI has about 4.3m shares outstanding at about \$10.50 per share for a market cap of about \$46m less \$12m of net cash or an enterprise value (EV) of about \$34m. LTM adjusted EBITDA is about \$5m, so EEI is trading at 7x LTM adjusted EBITDA. LTM revenues are about \$101m and LTM free cash flow is about \$5m so EEI is trading at about 34% of LTM revenues and a 14% unleveraged FCF yield. We think these valuation metrics are attractive for an established provider of environmental consulting services in the U.S. and South America with a cash-generative business model, solid long-term revenue growth opportunities, cumulative cash from operations of about \$32m in past five years (100% of the current enterprise value), and a "Ft. Knox" balance sheet.

Further, EEI has a credit line of about \$35m which is almost completely unused, so that its unused credit line almost equals the enterprise value of the business.

We think EEI's total revenues could stabilize and grow modestly over the next few fiscal years, driven by increased backlog growth due to improved, more focused contract bidding procedures, better contract execution, and a stronger and expanded array of environmental service capabilities. EEI could benefit from an improved expense structure and more efficient operations as well as a possible recovery in its South American markets. It is possible that as energy prices and other commodity prices improve, this could help EEI's business. Although management is entrenched with a super-voting share structure, we believe they are motivated to improve profitability and the business model, as evidenced by the sale of unprofitable and unreliable foreign and domestic operations over the past few years.

We believe adjusted EBITDA could stabilize and grow to \$8m+ by fiscal year end 2018 and based on an 8x multiple of adjusted EBITDA plus \$20m in projected net cash by year end fiscal 2018, EEI could have a market cap of \$84m and a share price of close to \$20 per share (+100% from \$10 today).

### **Business and Industry Background**

There are many environmental consulting firms in the U.S. and globally which do many different things. EEI ranked number 70 among U.S. environmental consulting firms based in 2015 revenues. We believe the environmental services business is a decent

business with reasonable long term growth prospects. Firms like EEI have a large base of environmental engineers with significant experience executing contracts and a long-established set of relationships with both commercial and government organizations. We believe the overall industry is growing in the low to mid-single digit range and this growth rate is expected to continue over the next several years. EEI provides important consulting services for all types of energy projects (power transmission line, gas transmission pipelines, off-shore oil projects, etc.), water projects, infrastructure related projects, environmental preparedness projects, etc.

EEI offers consulting services to commercial and government clients in a variety of service sectors which include the following:

- Government START Contract – providing support services to the EPA for release and threat of release of oil and various hazardous substances and contaminants, to date supporting the EPA on over 40 contracts worth a total value of over \$1b
- Government Task Order Contract – numerous task order contracts with state and federal agencies with service provided including environmental assessment projects with the U.S. Navy, engineering and oversight of pollution remediation and preparing environmental impact assessments for federal land management agencies
- Electric Transmission – comprehensive approach to transmission project siting and permitting from experience on over 16,000 miles of transmission lines, including feasibility studies, alternate routes, environmental impacts, etc.
- Pipelines – has worked on over 250 projects in the pipeline industry involving more than 50,000 miles of systems, including route selection, evaluation of alternatives, field surveys, etc.
- Offshore – LNG industry has seen dramatic changes in last few years, where LNG terminals for import have shifted to LNG terminals for export due to natural gas in excess of domestic needs; EEI has extensive experience with offshore energy projects
- Wind – extensive experience providing consulting services to wind energy developers and team has collectively worked on more than 450 wind energy projects in 38 states, helping clients produce projects capable of more than 6,000 megawatts
- Solar – assisted solar developers to permit and build projects powering more than 6,000 megawatts of clear, renewable energy in 23 states,
- Natural Resource Management and Restoration – conceive and design projects that restore affected habitat through engineering solutions; current work includes clients such as Army Corps of Engineers to address invasive species such as hydrilla blooms in Great Lakes watershed
- Water Resources – water supply and management are becoming increasingly important issues and solutions must address stakeholder concerns, water rights, permitting rights, ecosystem sustainability, water supply and quality, and economic feasibility; the Company has experience working in the world's most important water systems including Florida Everglades, Louisiana Coastline, Great Lakes, Hudson River, Chesapeake Bay, Puget Sound, Amazon River, Yangtze River Basin, and many others.
- Planning – Environmental Planning and Assessment including environmental impact and work has included numerous major EIS and ER projects, initial studies, and EA's
- Emergency Planning and Management – provide logistical support, emergency response and management services, and comprehensive planning to businesses and state, country, and municipal governments in all phases including preparedness, response, mitigation, and recovery
- International – since inception, the Company has completed more than 50,000 environmental assignments in more than 120 countries around the world, with most of the services provided similar to those provided in the U.S. and as modernizing economies continue to develop, demand for global environmental services has grown, including numerous infrastructure related projects
- Regulatory Compliance – federal governments have enacted numerous environmental laws governing a wide range of topics, including National Environmental Policy Act, Clean Air Act, Safe Drinking Water Act, Endangered Species Act, Atomic Energy Act, and many others.

The Company also provides services to various phases of energy development by conducting critical feature/fatal flaw analyses,

social and health impact assessments, feasibility and siting studies, field surveys, permitting, construction inspection, and compliance monitoring. In addition, it conceives and designs environmental restoration projects that restore affected habitat through the integration of biological and engineering solutions, offers sustainability, resiliency, and climate adaptation services, as well as environmental planning and assessment, and military master planning and land use compatibility study services, and provides water supply, water quality, and watershed management services. The Company also offers logistical support, emergency response/management, and comprehensive planning services in various preparedness, mitigation, response, and recovery phases, as well as conducts hazardous waste site evaluations providing site investigation, engineering design, and operation and maintenance.

Additionally, it is involved in the management and financial planning; institutional strengthening and standards development; water supply and development; wastewater treatment; and solid waste project construction supervision assignments.

### **Other Information**

**Contract type revenue** - EEI's services are provided under three basic types of contracts – time and materials, cost plus fee, and firm fixed price. Time and materials contracts represented 54% of total revenue in fiscal 2014, 49% in fiscal 2015, and 50% in fiscal 2016. Cost plus fee contracts represented 7% of total revenue in fiscal 2014, 8% in fiscal 2015, and 11% in 2016. Firm fixed price contracts represented 39% of total revenues in fiscal 2014, 43% in fiscal 2015, and 39% in fiscal 2016.

**Backlog**- Total firm backlog of uncompleted contracts was \$92m at fiscal year-end 2016 versus \$81m at fiscal year-end 2015.

**Employees** – EEI has reduced and focused its employee base since fiscal year end 2012, when it had 1,175 full time employees to 735 full time employees at fiscal year-end 2016.

### **Stabilized Results for Six Months of Fiscal 2017 / Improvement in U.S. Operations Masked by Weak South American Markets**

For six months of fiscal 2017, total revenues decreased from \$55m to \$50m due to declines in revenues in U.S. and South American operations. Direct and indirect costs were reduced significantly resulting in adjusted EBITDA of \$2.2m versus \$2.7m in prior year. Global trends in oil, gas, and commodity prices continued to have a negative impact on revenues from energy and mining sectors in the U.S. EEI also experienced a shift in direct labor hours from commercial projects to government projects, for which selling rates tend to be lower. However, in Q2 2017, total revenues were flat and adjusted EBITDA increased due to reduced expense structures.

Segment results (see below) show a dramatic improvement in profitability in U.S. operations since the new management took over due to sharply reduced indirect expenses from \$42m in 2014 to \$36m in 2015 to increase pre-tax profits from U.S. operations from a loss of \$2.8m in 2014 to a profit of \$4.6m in 2015. However, the South American revenues dropped sharply in 2016 with weaker energy and natural resource prices and largely offset the gains in U.S. operations in 2016. New management has done an effective job of improving U.S. operations and is sharply reducing expenses in South American operations to better match the current weak demand environment.

### **Potential Revenue Growth Opportunities**

In terms of potential revenue growth opportunities, there are many programs EEI management is pursuing. South American

operations could eventually benefit from a modest recovery in energy and natural resource markets and will be helped by a streamlined cost structure. U.S. operations should benefit as EEI has expanded service offerings in growing areas such as resiliency and sustainability planning, water resources, coastal restoration, and permitting of off-shore wind and renewable energy facilities. EEI established a corporate development team in fiscal 2016 to cultivate growth opportunities through strategic business partnerships and investments. EEI has made strategic hires and technologies and actively developing acquisition opportunities to further align EEI capabilities with market opportunities and provide revenue growth.

### **Strong Cash-Generative Business Model and Attractive FCF yield**

EEI has a highly cash generative business model which is asset-light with limited capital expenditures and working capital needs. EEI trades at an attractive 14% unleveraged FCF yield, with decent prospects for modest growth in revenues, adjusted EBITDA, and FCF by fiscal year end July 2018. EEI has a high ROIC business model (about 25%) based on EBIT versus the investment in net working capital plus net PPE. With modest revenue growth, we think EEI can generate significant incremental adjusted EBITDA and FCF. A significant portion of adjusted EBITDA converts to cash from operations and free cash flow. EEI's capital expenditures are minimal at only about \$0.5m for the past several years. EEI's business model enables EEI to consistently generate strong free cash flow, even in the current depressed climate for natural resources.

### **Attractive Nearly 4% Dividend Yield / Motivated Controlling Shareholders**

EEI has paid strong dividends in recent years as its balance sheet has strengthened. The Company currently pays a 20 cent per share semi-annual dividend which annualizes to 40 cents per year. Based on this dividend rate and EEI's current stock price of about \$10.50 per share, EEI currently has a dividend yield of close to 4% which is attractive. EEI's current dividend rate is well covered by its current cash flow and earnings results as well as its strong liquidity position. We believe the strong payout of dividends and the aggressive cost reduction and business rationalization actions by the management of EEI indicate that management and control shareholders are motivated to drive shareholder value.

### **Attractive Valuation For High ROIC Business Model**

The Company is attractively valued at an enterprise value (EV) to total revenues of about 0.3x and EV to adjusted EBITDA of about 7x and a FCF yield of about 14% on an unleveraged basis. We believe these valuation metrics are attractive for a cash-generative business with a solid 25% ROIC in an industry which is growing and in which consolidation is occurring.

### **Company is Closely Controlled But Focused on Increasing Shareholder Value**

The Company is closely controlled by a super majority shareholder group but there has been a major improvement under new management and more aggressive focus on shareholder value. In August 2013, there was a major change in leadership and strategy and, in March 2015, Gerald Gallagher became CEO. The new management team has aggressively moved to exit non-strategic business segments and geographies which are not contributing to profits and cash flows. They have also sharply reduced EEI's cost base for its remaining business segments in the U.S. and South America in response to weaker revenues due to the decline in energy and other commodity prices.

### **Activist Private Equity Shareholder Mill Road Has Already Made An Offer**

Mill Road Capital is the largest non-management shareholder of EEI, owning about 450,000 Class A shares. Mill Road is a group of ex-Blackstone Partners with a successful strategy focused on smaller public companies. We have invested in several other small public companies where Mill Road was involved, including Rubio's Restaurants (RUBO), Harris Interactive (HPOL), and R.G. Barry (DFZ) and all three of these companies were eventually purchased. Mill Road has often made a bid to acquire the company themselves. Mill Road offered to purchase EEI for \$14 to \$15 per share in mid-2015 which offer was rejected almost immediately by the control shareholders. Mill Road purchased the shares of one of EEI's founders at about \$11 per share. Mill Road has recently filed to try to get two seats on EEI's Board of Directors at the 2017 shareholders meeting. There was a proxy fight and this was recently settled with Mill Road receiving two seats on EEI's Board. We believe this is a major positive since a significant risk with this investment would be a value-destroying acquisition and we believe Mill Road's presence makes this less likely. We believe Mill Road could add significant value in regard to capital allocation decisions for EEI going forward. Clearly, there cannot be an acquisition transaction without the consent of the Control Shareholder Group but we believe Mill Road's involvement is a positive and a solid indicator of potential value at EEI. It has been reported that in recent years two European firms and two U.S. firms (one of which was Mill Road) have indicated an interest in acquiring EEI.

### **Initial Signs of Stabilization of Weak South American Markets**

After several difficult quarters, the Company's operations in South America seem to have stabilized. EEI has sharply reduced indirect costs in South American markets to try to match expenses with revenues. These markets are dependent on natural resource prices and remain depressed but in Q2 2017, South American operations were close to break even. EEI operates in three markets in South America, including Brazil, Peru, and Chile. EEI has sharply reduced indirect expenses in these markets to minimize losses in the current depressed environment. There is some evidence Brazil's economy may be stabilizing and Brazil's profitability has improved greatly for fiscal year 2017 year to date.

### **Significant Excess Liquidity / Available Credit Line Almost Exceeds Enterprise Value**

EEI has very significant excess liquidity which we believe reduces risk. In addition to a net cash balance of about \$12m, or over 25% of the current market valuation, EEI has a line of credit of about \$35m, which is almost completely unused. This unused credit line is almost equal to the market cap of the Company. We believe this significant excess liquidity provides management with several additional levers to drive shareholder value should it choose to exercise them. It is extremely rare for a company to be able to borrow almost its entire market value through a line of credit. Typically bank lenders take a much more conservative view of valuation than the equity markets and we believe this speaks to the value inherent in EEI's cash-generative environmental services business model. We also believe it helps greatly reduce the risk of the investment.

### **Attractive Upside Potential**

In fiscal 2016 ended July 31, EEI generated \$6m of adjusted EBITDA and \$5m of FCF (cash from operations less capital expenditures). We believe EEI can grow adjusted EBITDA and FCF by fiscal year end July 2018 based on a stabilized South American business and a stronger, expanded service offering along with a streamlined cost structure. We believe EEI bookings can increase and this will lead to increased revenue, adjusted EBITDA, and FCF.

We believe EEI could generate adjusted EBITDA of \$8m in fiscal year ended July 2018 with net cash of \$20m by fiscal year end 2018. This would represent an 8% adjusted EBITDA margin on total revenues of about \$100m which we believe is reasonable.

Once revenues and adjusted EBITDA are growing again, we believe EEI could trade for 8x adjusted EBITDA in fiscal 2018 plus \$20m of net cash at fiscal year-end 2018 or \$84m or \$20 per share, 100% higher than the current \$10 per share.

### **Solid Balance Sheet and Expected Steady Build-up in Net Cash Position.**

EEI has a “Ft. Knox” balance sheet with a net cash position of \$12m at January 2017 or about 25% of the market cap. We believe EEI can generate \$5m+ of FCF per year in fiscal years ended July 2017 and July 2018 and we think EEI could end fiscal 2018 with a net cash position of \$20m+. Alternatively, management may use the strong cash position to repurchase shares, pay dividends, or complete accretive acquisitions. We think the potential build up in net cash in fiscal years 2017 and 2018 will continue to highlight the strong cash generating capabilities of the business model and could attract investor attention. Further, EEI has a credit line of about \$35m, which is almost completely unused, and has very low borrowing rates.

### **Recent Acquisition Activity in Environmental Services Space**

There have been acquisition transactions in the environmental services industry over the last few years. Most recently, a similar but larger company, TRC Companies (TRR) was acquired for about 13x adjusted EBITDA by New Mountain Capital, a well-respected private equity firm in a total transaction value of about \$650m. In 2013, Michael Baker Companies (BAKR), a Pittsburg, PA based engineering and environmental services company was acquired by DC Partners, a Washington D.C. based private equity firm for a transaction value of about \$350m.

### **Conclusion and Target Price**

Based on 8x our adjusted EBITDA estimate of \$8m for fiscal 2018 plus a projected \$20m+ net cash position at fiscal year-end 2018, we believe EEI could trade for a market cap of close to \$84m or \$20 per share or more versus \$10.50 per share today (+100%). If EEI continues to execute and its environmental consulting and services business performs as we expect, we think our target price can be achieved. Further, EEI’s strong environmental services business, knowledgeable employee base, and long-term, well-established customer relationships in key areas of the environmental services industry could prove attractive to a strategic or private equity acquirer.

| <b>Major Shareholders<br/>(a)</b> |     |       |
|-----------------------------------|-----|-------|
| Mill Road Capital                 | 432 | 14.4% |
| North Star Invest.                | 249 | 8.3%  |

|                    |     |      |
|--------------------|-----|------|
| Wedbush Securities | 164 | 5.5% |
| Franklin Advisory  | 144 | 4.8% |
| Dimensional Fund   | 138 | 4.6% |
| Minerva Advisors   | 78  | 2.5% |

(a) Founding shareholders Trust owns 1.2m Class B shares of stock with super-voting rights of 10 votes per share while Class A shares receive one vote per share.

|                    |         |        |  | <b>Average Daily Volume</b> |  |
|--------------------|---------|--------|--|-----------------------------|--|
| Price per share    | \$10.50 |        |  | 8,000                       |  |
| Shares outstanding | 4.2     |        |  |                             |  |
| Market value       | \$44    |        |  |                             |  |
|                    |         |        |  |                             |  |
| 52-week range      | \$8.8   | \$10.7 |  |                             |  |
|                    |         |        |  |                             |  |

| <b>Income statements</b>    |             |             |             |             |             |             |                   |                   |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------------|-------------------|
|                             |             |             |             |             |             |             | <b>6mos.</b>      | <b>6mos.</b>      |
| <b>FYE 7/31</b>             | <b>2011</b> | <b>2012</b> | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>2016</b> | <b>2016</b>       | <b>2017</b>       |
| Sales                       | \$169       | \$155       | \$135       | \$128       | \$127       | \$106       | \$55              | \$50              |
| Gross profit                | \$72        | \$68        | \$60        | \$58        | \$56        | \$47        | \$25              | \$22              |
| SG&A expense                | \$60        | \$63        | \$61        | \$59        | \$48        | \$44        | \$23              | \$20              |
| Adjusted EBITDA (1)         | \$14        | \$7         | \$1         | \$4         | \$9         | \$5         | \$3               | \$2               |
| Adjusted EBIT (1)           | \$12        | \$5         | (\$1)       | (\$1)       | \$8         | \$4         | \$2               | \$2               |
| Net income                  | \$8         | \$3         | (\$2)       | (\$1)       | \$3         | \$1         | \$0               | \$                |
| Cash EPS – cont. ops        | \$          | \$          | \$          | \$          | \$          | \$0.21      | \$0.04            | \$0.13            |
| Gross margin %              | 42.6%       | 43.9%       | 44.5%       | 45.2%       | 44.1%       | 44%         | 44.7%             | 44.5%             |
| Adjusted EBITDA %           | 8.3%        | 4.5%        | 1.0%        | 2.8%        | 7.1%        | 4.7%        | 4.4%              | 4.2%              |
| <b>Cash flow statements</b> |             |             |             |             |             |             |                   |                   |
| <b>FYE 7/31</b>             | <b>2011</b> | <b>2012</b> | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>2016</b> | <b>6mos. 2016</b> | <b>6mos. 2017</b> |
| Net income                  | \$8         | \$3         | (\$2)       | (\$1)       | \$4         | \$1         | \$0               | \$1               |
| Dep & amortization          | \$2         | \$2         | \$2         | \$4         | \$2         | \$1         | \$1               | \$0               |
| Non-cash adjustment         | \$3         | \$2         | \$7         | \$0         | \$1         | \$2         | \$1               | \$2               |
| Working capital changes     | (\$12)      | (\$8)       | \$4         | \$5         | \$0         | \$2         | \$2               | \$0               |

|                             |             |              |             |             |             |             |                |            |
|-----------------------------|-------------|--------------|-------------|-------------|-------------|-------------|----------------|------------|
| <b>Cash from operations</b> | <b>\$1</b>  | <b>(\$1)</b> | <b>\$11</b> | <b>\$8</b>  | <b>\$7</b>  | <b>\$6</b>  | <b>\$4</b>     | <b>\$3</b> |
| Capital expenditures        | (\$3)       | (\$4)        | (\$2)       | (\$2)       | (\$1)       | (\$1)       | (\$0)          | (\$0)      |
| Dividends                   | \$0         | \$0          | (\$4)       | (\$2)       | (\$2)       | (\$2)       | (\$1)          | (\$1)      |
| Share repurchases           | \$0         | \$0          | \$0         | \$0         | \$0         | \$0         | \$0            | \$0        |
| Acquisitions                | (\$1)       | (\$1)        | \$0         | \$0         | \$0         | \$0         | \$0            | \$0        |
| <b>Est. free cash flow</b>  | <b>\$0</b>  | <b>(\$5)</b> | <b>\$9</b>  | <b>\$6</b>  | <b>\$5</b>  | <b>\$5</b>  | <b>\$2</b>     | <b>\$1</b> |
| <b>Balance sheets</b>       |             |              |             |             |             |             |                |            |
| <b>FYE 7/31</b>             | <b>2011</b> | <b>2012</b>  | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>2016</b> | <b>1/28/17</b> |            |
| Cash                        | \$10        | \$12         | \$11        | \$8         | \$10        | \$12        | \$13           |            |
| Total assets                | \$94        | \$98         | \$82        | \$72        | \$69        | \$60        | \$58           |            |
| Total debt                  | \$2         | \$14         | \$14        | \$2         | \$2         | \$1         | \$1            |            |
| Shareholder equity          | \$54        | \$53         | \$44        | \$38        | \$37        | \$38        | \$37           |            |
|                             |             |              |             |             |             |             |                |            |
| Net debt / (cash)           | (\$8)       | \$2          | (\$4)       | (\$6)       | (\$9)       | (\$11)      | (\$12)         |            |
|                             |             |              |             |             |             |             |                |            |
| Shares outstanding          | 4.3         | 4.3          | 4.3         | 4.3         | 4.3         | 4.3         | 4.3            |            |

|   |        |                                   |     |
|---|--------|-----------------------------------|-----|
|   |        |                                   |     |
| <b>Valuation &amp; Valuation Ratios</b> |        |                                   |     |
| Market value                            | \$44   | EV / Adjusted EBITDA              | 7.0 |
| Net cash                                | (\$12) | Enterprise Value / Free Cash Flow | 6.0 |
| Preferred                               | \$0    | Enterprise Value / Cash from Ops  | 6.0 |
| Enterprise value                        | \$32   | Enterprise Value / Revenues       | 30% |
|   |        |                                   |     |

|                    |         |        |  |  |                          |  |  |
|--------------------|---------|--------|--|--|--------------------------|--|--|
| Price per share    | \$10.50 |        |  |  |                          |  |  |
| Shares outstanding | 4.2     |        |  |  |                          |  |  |
| Market value       | \$44    |        |  |  | <u>Avg. Daily Volume</u> |  |  |
|                    |         |        |  |  | 8,000                    |  |  |
| 52-week range      | \$8.8   | \$10.7 |  |  |                          |  |  |
|                    |         |        |  |  |                          |  |  |

### Detailed Segment Income Statements

|  | <u>2013</u> | <u>2014</u> | <u>2015</u> | <u>2016</u> | <u>6mos 2016</u> | <u>6mos 2017</u> |
|--|-------------|-------------|-------------|-------------|------------------|------------------|
|--|-------------|-------------|-------------|-------------|------------------|------------------|

| <b>EI and subsidiaries located in U.S.</b> |  |         |        |        |        |        |
|--|--|---------|--------|--------|--------|--------|
| Revenue, net                               |  | \$85.5  | \$88.7 | \$83.1 | \$42.7 | \$39.3 |
| Revenue, net less subcontract costs        |  | \$73.8  | \$73.3 | \$69.7 | \$19.6 | \$17.5 |
| Direct operating expenses                  |  | \$30.7  | \$32.3 | \$30.4 | \$8.3  | \$7.4  |
| Indirect operating expenses                |  | \$42.1  | \$35.6 | \$34.1 | \$8.7  | \$8.2  |
| Income before income tax                   |  | (\$2.8) | \$4.6  | \$4.7  | \$2.4  | \$1.7  |

|                                |  |         |       |       |       |       |
|--------------------------------|--|---------|-------|-------|-------|-------|
| Net income attributable to EEI |  | (\$2.8) | \$1.0 | \$2.0 | \$1.2 | \$1.2 |
|--------------------------------|--|---------|-------|-------|-------|-------|

|  |    |        |        |         |         |         |
|--|----|--------|--------|---------|---------|---------|
| <b>Subsidiaries located in South America</b> |    |        |        |         |         |         |
| Revenue, net                                 |    | \$42.6 | \$38.2 | \$22.7  | \$18.7  | \$19.0  |
| Revenue, net less subcontract costs          |    | \$33.4 | \$30.3 | \$17.5  | \$4.8   | \$3.9   |
| Direct operating expenses                    |    | \$18.5 | \$15.2 | \$9.1   | \$2.4   | \$2.0   |
| Indirect operating expenses                  |    | \$10.9 | \$10.3 | \$8.2   | \$2.2   | \$2.0   |
| Income before income tax                     | \$ | \$3.6  | \$4.4  | (\$0.2) | \$0.2   | (\$0.2) |
| Net income attributable to EEI               | \$ | \$2.0  | \$3.0  | (\$1.1) | (\$0.5) | (\$0.3) |
|  |    |        |        |         |         |         |

### **Detailed Income Statements**

|  |             |             |             |             |             |                         |                         |             |             |                            |                            |
|--|-------------|-------------|-------------|-------------|-------------|-------------------------|-------------------------|-------------|-------------|----------------------------|----------------------------|
|  | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>-</u><br><u>2013</u> | <u>-</u><br><u>2014</u> | <u>2015</u> | <u>2016</u> | <u>6mos</u><br><u>2016</u> | <u>6mos</u><br><u>2017</u> |
|--|-------------|-------------|-------------|-------------|-------------|-------------------------|-------------------------|-------------|-------------|----------------------------|----------------------------|

|               |       |       |       |       |       |       |       |       |       |      |      |
|---------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|------|
| Total Revenue | \$111 | \$147 | \$149 | \$169 | \$155 | \$135 | \$128 | \$127 | \$106 | \$55 | \$50 |
|---------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|------|

|  |       |       |       |       |       |       |       |       |       |      |      |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|------|
| Cost of professional services and other direct | \$45  | \$50  | \$50  | \$66  | \$56  | \$50  | \$49  | \$48  | \$40  | \$20 | \$18 |
| Subcontract costs                              | \$16  | \$38  | \$31  | \$30  | \$32  | \$25  | \$21  | \$23  | \$19  | \$10 | \$10 |
| Administration and indirect operating expenses | \$31  | \$34  | \$38  | \$43  | \$45  | \$45  | \$42  | \$36  | \$31  | \$16 | \$15 |
| Marketing and related costs                    | \$12  | \$13  | \$14  | \$15  | \$16  | \$14  | \$13  | \$11  | \$11  | \$6  | \$5  |
| Depreciation and amortization                  | \$2   | \$2   | \$2   | \$2   | \$2   | \$2   | \$4   | \$2   | \$1   | \$1  | \$1  |
| Total operating ex                             | \$106 | \$137 | \$135 | \$157 | \$151 | \$136 | \$129 | \$120 | \$102 | \$53 | \$49 |
| Operating income                               | \$5   | \$10  | \$10  | \$12  | \$4   | (\$1) | (\$1) | \$7   | \$4   | \$2  | \$1  |
| Other Income                                   | \$    | \$    | \$    | \$    | \$    | \$    | \$    | \$    |       |      |      |
| Taxes  | \$    | \$    | \$    | \$    | \$    | \$    | \$    | \$    |       |      |      |
| Net income                                     | \$    | \$    | \$    | \$    | \$    | \$    | \$    |       |       |      |      |
|  |       |       |       |       |       |       |       |       |       |      |      |
| Gross profit                                   | \$50  | \$59  | \$64  | \$72  | \$67  | \$60  | \$58  | \$56  | \$47  | \$25 | \$22 |
| Gross margin %                                 | 45%   | 40%   | 44%   | 43%   | 43%   | 44%   | 45%   | 44%   | 44%   | 46%  | 44%  |
|  |       |       |       |       |       |       |       |       |       |      |      |
| Adjusted EBITDA                                | \$7   | \$12  | \$12  | \$14  | \$6   | \$7   | \$3   | \$9   | \$5   | \$3  | \$2  |
| Adjusted EBITDA %                              | 6.3%  | 8.7%  | 8.2%  | 8.2%  | 3.9%  | 0.7%  | 2.3%  | 7.0%  | 4.7%  | 6%   | 4%   |

---

**Detailed Quarterly Income Statements**

|               | <u>1/14</u> | <u>4/14</u> | <u>7/14</u> | <u>10/14</u> | <u>1/15</u> | <u>4/15</u> | <u>7/15</u> | <u>10/15</u> | <u>1/16</u> | <u>4/16</u> | <u>7/16</u> | <u>10/16</u> | <u>1/17</u> |
|---------------|-------------|-------------|-------------|--------------|-------------|-------------|-------------|--------------|-------------|-------------|-------------|--------------|-------------|
| Total Revenue | \$29.1      | \$31.5      | \$          | \$33.2       | \$28.2      | \$30.4      | \$41.0      | \$30.0       | \$24.6      | \$25.2      | \$26.0      | \$25.6       | \$24.8      |

|  |         |        |    |        |        |        |        |        |         |        |        |        |        |
|--|---------|--------|----|--------|--------|--------|--------|--------|---------|--------|--------|--------|--------|
| Cost of professional services and other direct | \$10.6  | \$10.5 | \$ | \$12.6 | \$11.0 | \$11.5 | \$12.4 | \$10.7 | \$9.4   | \$9.3  | \$10.0 | \$9.4  | \$9.0  |
| Subcontract costs                              | \$5.6   | \$6.2  |    | \$5.7  | \$5.2  | \$4.8  | \$7.6  | \$5.6  | \$4.7   | \$3.9  | \$4.4  | \$4.3  | \$5.4  |
| Administrative & other indirect costs          | \$10.2  | \$10.2 | \$ | \$9.4  | \$8.7  | \$8.0  | \$9.5  | \$8.0  | \$7.9   | \$8.2  | \$7.1  | \$7.4  | \$7.5  |
| Marketing and related costs                    | \$3.0   | \$3.5  | \$ | \$3.4  | \$2.8  | \$2.5  | \$2.7  | \$3.0  | \$2.8   | \$3.0  | \$2.5  | \$2.9  | \$2.3  |
| D & A expense                                  | \$1.1   | \$1.0  | \$ | \$0.4  | \$0.4  | \$0.4  | \$0.3  | \$0.2  | \$0.3   | \$0.3  | \$0.3  | \$0.2  | \$0.3  |
|  |         |        |    |        |        |        |        |        |         |        |        |        |        |
| Total operating expenses                       | \$30.5  | \$31.4 | \$ | \$31.5 | \$28.1 | \$27.2 | \$32.5 | \$27.5 | \$25.1  | \$24.7 | \$24.3 | \$24.2 | \$24.5 |
|  |         |        |    |        |        |        |        |        |         |        |        |        |        |
| Operating income                               | (\$1.3) | \$0.1  | \$ | \$1.8  | \$0.0  | \$3.1  | \$     | \$2.6  | (\$0.5) | \$0.6  | \$1.7  | \$1.4  | \$0.5  |

|                 |        |        |    |        |        |        |        |        |         |        |        |        |        |
|-----------------|--------|--------|----|--------|--------|--------|--------|--------|---------|--------|--------|--------|--------|
| Gross profit    | \$12.9 | \$14.8 |    | \$14.9 | \$12.0 | \$14.1 | \$21.0 | \$13.7 | \$10.5  | \$12.0 | \$11.6 | \$11.9 | \$10.8 |
| Gross margin %  | 44%    | 47%    | %  | 45%    | 43%    | 46%    | 51%    | 46%    | 43%     | 48%    | 45%    | 47%    |        |
|                 |        |        |    |        |        |        |        |        |         |        |        |        |        |
| Adjusted EBITDA | \$     | \$     | \$ | \$2.2  | \$0.4  | \$3.5  | \$3.0  | \$2.8  | (\$0.2) | \$0.9  | \$2.0  | \$1.6  | \$0.5  |

**Detailed Quarterly Balance Sheets**

|                           | <u>10/13</u> | <u>1/14</u> | <u>4/14</u> | <u>7/14</u> | <u>10/14</u> | <u>1/15</u> | <u>4/15</u> | <u>7/15</u> | <u>10/15</u> | <u>1/16</u> | <u>4/16</u> | <u>7/16</u> | <u>10/16</u> |
|---------------------------|--------------|-------------|-------------|-------------|--------------|-------------|-------------|-------------|--------------|-------------|-------------|-------------|--------------|
| Cash and equivalents      | \$11         | \$10        | \$8         | \$8         | \$8          | \$7         | \$7         | \$10        | \$12         | \$12        | \$10        | \$12        | \$13         |
| Contract receivables, net | \$47         | \$41        | \$44        | \$44        | \$47         | \$42        | \$42        | \$43        | \$34         | \$34        | \$35        | \$34        | \$32         |
| Other current assets      | \$11         | \$10        | \$9         | \$7         | \$7          | \$7         | \$6         | \$2         | \$3          | \$3         | \$3         | \$3         | \$5          |

|               |      |      |      |      |      |      |      |      |      |      |      |      |      |
|---------------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Total current | \$69 | \$61 | \$61 | \$60 | \$62 | \$57 | \$55 | \$55 | \$49 | \$49 | \$47 | \$49 | \$50 |
|---------------|------|------|------|------|------|------|------|------|------|------|------|------|------|

|                     |      |      |      |      |      |      |      |      |      |      |      |      |      |
|---------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| PPE, net            | \$9  | \$9  | \$8  | \$8  | \$8  | \$8  | \$7  | \$7  | \$6  | \$7  | \$6  | \$6  | \$5  |
| Deferred tax assets | \$1  | \$1  | \$1  | \$2  | \$2  | \$2  | \$2  | \$5  | \$3  | \$4  | \$4  | \$3  | \$2  |
| Other assets        | \$2  | \$2  | \$2  | \$2  | \$2  | \$2  | \$2  | \$2  | \$1  | \$2  | \$2  | \$2  | \$2  |
| Total assets        | \$81 | \$73 | \$73 | \$72 | \$74 | \$68 | \$66 | \$69 | \$60 | \$61 | \$59 | \$60 | \$59 |

|                               |     |     |     |      |     |     |     |      |     |     |     |     |     |
|-------------------------------|-----|-----|-----|------|-----|-----|-----|------|-----|-----|-----|-----|-----|
| A/P                           | \$8 | \$8 | \$7 | \$10 | \$9 | \$8 | \$7 | \$10 | \$7 | \$7 | \$6 | \$7 | \$7 |
| Accrued expenses              | \$8 | \$7 | \$8 | \$8  | \$9 | \$8 | \$7 | \$9  | \$5 | \$7 | \$6 | \$7 | \$5 |
| CPLTD                         | \$7 | \$3 | \$2 | \$2  | \$4 | \$2 | \$2 | \$1  | \$1 | \$1 | \$1 | \$0 | \$1 |
| Billings in excess of revenue | \$6 | \$6 | \$6 | \$5  | \$5 | \$5 | \$4 | \$3  | \$3 | \$3 | \$3 | \$3 | \$4 |
| Other current liabilities     | \$4 | \$4 | \$4 | \$4  | \$4 | \$4 | \$4 | \$4  | \$3 | \$3 | \$3 | \$3 | \$3 |

|               |      |      |      |      |      |      |      |      |       |      |      |      |      |
|---------------|------|------|------|------|------|------|------|------|-------|------|------|------|------|
| Total current | \$34 | \$28 | \$28 | \$29 | \$30 | \$27 | \$24 | \$27 | \$ 21 | \$22 | \$20 | \$21 | \$19 |
|---------------|------|------|------|------|------|------|------|------|-------|------|------|------|------|

|     |     |     |     |     |     |     |     |     |     |     |     |     |     |
|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| LTD | \$1 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|

|                    |              |              |              |              |              |              |              |              |               |               |              |               |               |
|--------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|--------------|---------------|---------------|
| Other liabilities  | \$0          | \$1          | \$1          | \$1          | \$1          | \$1          | \$1          | \$2          | \$0           | \$0           | \$0          | \$0           | \$0           |
|                    |              |              |              |              |              |              |              |              |               |               |              |               |               |
| Shareholder equity | \$46         | \$43         | \$44         | \$42         | \$42         | \$39         | \$42         | \$40         | \$38          | \$38          | \$39         | \$38          | \$39          |
|                    |              |              |              |              |              |              |              |              |               |               |              |               |               |
| <b>Net Debt</b>    | <b>(\$3)</b> | <b>(\$7)</b> | <b>(\$6)</b> | <b>(\$6)</b> | <b>(\$3)</b> | <b>(\$5)</b> | <b>(\$5)</b> | <b>(\$9)</b> | <b>(\$11)</b> | <b>(\$11)</b> | <b>(\$9)</b> | <b>(\$11)</b> | <b>(\$12)</b> |
|                    |              |              |              |              |              |              |              |              |               |               |              |               |               |

|      | <b><u>Ecology and Environment, Inc. (EEI)</u></b>  | <b><u>ICF International (ICFI)</u></b>  | <b><u>TRC Companies (TRR)</u></b>   | <b><u>Leidos Holdings (LDOS)</u></b>  |
|------|--|---|---|---|
|      | Environmental consulting firm that provides professional services to government and private clients worldwide with about 36 regional offices in the U.S. and 11 international offices and about 735 full time employees. | Provides mgmt., technology, and policy consulting and implementation services to government and commercial clients in U.S. and internationally, with 5,000 employees. | Provides engineering, consulting, and construction mgmt. services in the U.S. Segments include Energy, Environmental, and Infrastructure, with 4,800 employees. | Provides technology and engineering solutions in defense, homeland security, civil, and health markets in the U.S. and internationally with 38,000 employees. |
| Cash | \$13m  | \$8m  | \$6m  | \$200m  |

|                   |         |        |         |         |  |
|-------------------|---------|--------|---------|---------|--|
| LTD               | \$1m    | \$276m | \$91m   | \$3.2b  |  |
| Price             | \$10.50 | \$48   | \$17.50 | \$53    |  |
| Shares            | 4.3m    | 19m    | 32m     | 151m    |  |
| Market Cap        | \$45m   | \$900m | \$560m  | \$7.9b  |  |
| Enter. Value (EV) | \$34m   | \$1.2b | \$645m  | \$10.9b |  |
| Rev - LTM         | \$102m  | \$1.2b | \$530m  | \$8.0b  |  |

|                          |           |           |           |           |  |
|--------------------------|-----------|-----------|-----------|-----------|--|
| Adj. EBITDA – LTM        | \$5m      | \$111m    | \$50m     | \$780m    |  |
| Adj. EBITDA – 2016       | \$5m      | \$111m    | \$50m     | \$780m    |  |
| Adj. EBITDA margin       | 5.0%      | 9.3%      | 9.4%      | 9.8%      |  |
| EV to Adj. EBITDA        | 7.0x      | 10.8x     | 12.9x     | 14.0x     |  |
| EV to LTM Revenues       | 0.3x      | 1.0x      | 1.2x      | 1.4x      |  |
| LTM Capital Expenditures | \$0.3m    | \$13m     | \$8m      | \$29m     |  |
| Cap Ex to Revenues       | 0.3%      | 1%        | 1.5%      | 0.4%      |  |
| Revenue per employee     | \$120,000 | \$240,000 | \$110,000 | \$250,000 |  |
| LTM Free Cash Flow       | \$5m      | \$65m     | \$40m     | \$400m    |  |
| FCF to EV                | 14%       | 5%        | 6%        | 4%        |  |

## Catalysts

1. Low valuation for a cash-generative, high ROIC (25%+) environmental services company (14%+ unleveraged FCF yield, 7.0x adjusted EBITDA, and 0.3x LTM revs).
2. Steady build-up of net cash on balance sheet, from \$12m of net cash at January 2017 to an estimated \$20m+ at fiscal year-end July 2018.
3. Projected adjusted EBITDA of \$8m+ for fiscal year-end July 2018.
4. Stabilization in backlog and revenues from organic growth programs (streamlined cost structure, enhanced bidding procedures, improved array of services and solutions).
5. Growth in revenues and adjusted EBITDA through organic programs and investments and niche acquisitions.
6. Share repurchases and dividends from excess cash and FCF generation.
7. Possible acquisition of EEI by a strategic or financial purchaser.
8. Increased analyst coverage and recognition of EEI.

### **Risks**

1. The U.S. and/or global economies decline.
2. Risk of a value-trap situation, with entrenched management and Board not focused on driving shareholder value (we do not think this is the case).
3. EEI's revenues and profits have been declining in recent years due to increased price competition in U.S. markets and weak South American markets. These trends could continue longer than we believe.
4. EEI is unable to win new contracts and increase backlog as we expect.
5. Backlog additions and re-competes can be extremely volatile from quarter to quarter, which can significantly impact revenues and profits.
6. Misallocation of capital into a poor acquisition.
7. EEI is a small company and quarterly results can be volatile.
8. Management is uncommunicative with shareholders (this could change with Mill Road on the Board but maybe not)
9. Going private transaction led by largest shareholder at below fair value. Control shareholders own super-voting stock.
10. We are defining FCF as cash from operations less capital expenditures and including non-cash stock comp and some other add-backs which some investors would not want to include.

### **Disclaimer**

Disclaimer: We own shares of EEI. We may buy or sell these shares at any time without notice. The information in the write-up is believed to be correct as of the date written but VIC members should do their own verification of this information and analysis of this potential investment. We undertake no obligation to update this write-up if new information arises at a future date.

I do not hold a position with the issuer such as employment, directorship, or consultancy.  
I and/or others I advise do not hold a material investment in the issuer's securities.

## Catalyst

see above

# Messages

---

**Subject** Author Exit Recommendation

**Entry** 10/03/2019 12:49 PM

**Member** andreas947

The author has recommended exiting the position