Mastech Digital Inc.
4Q 2021 Earnings Call
February 9, 2022

Operator
Greetings. And welcome to Mastech Digital Inc.'s Fourth Quarter 2021 Earnings Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone requires operator assistance during the conference, please press "*" "0" on your telephone keypad. As a reminder, this conference is being recorded. It is now my pleasure to introduce your host Jennifer Ford Lacey, Manager of Legal Affairs for Mastech Digital Inc. Thank you, Ms. Ford Lacey. You may begin.

Jennifer Ford Lacey
Thank you, operator. And welcome to Mastech Digital's fourth quarter 2021 conference call. If you have not yet received a copy of our earnings announcement, it can be obtained from our website at www.mastechdigital.com. With me on the call today are Vivek Gupta, Mastech Digital's Chief Executive Officer; and Jack Cronin, our Chief Financial Officer.

I would like to remind everyone that statements made during this call that are not historical facts are forward-looking statements. These forward-looking statements include our financial, growth, and liquidity projections, as well as statements about our plans, strategies, intentions, and beliefs concerning the business, cash flows, costs, and the markets in which we operate.

Without limiting the foregoing, the words believes, anticipates, plans, expects, and similar expressions are intended to identify certain forward-looking statements. These statements are based on information currently available to us. And we assume no obligation to update these statements as circumstances change.

There are risks and uncertainties that could cause actual events to differ materially from these forward-looking statements, including those listed in the company's 2020 annual report on Form 10-K filed with the Securities and Exchange Commission and available on its website at www.sec.gov.

Additionally, management has elected to provide certain non-GAAP financial measures to supplement our financial results presented on a GAAP basis. Specifically, we will provide non-GAAP net income and non-GAAP diluted earnings per share data, which we believe will provide greater transparency with respect to the key metrics used by management in operating the business.

Reconciliations of these non-GAAP financial measures to their comparable GAAP measures are included in our earnings announcement, excuse me – which, uh, are included in our earnings announcement which can be obtained from our website at www.mastechdigital.com. As a reminder, we will not be providing guidance during this call nor will we provide guidance in any subsequent one-on-one meetings or calls. I will now turn the call over to Jack for a review of our fourth quarter and full-year 2021 results.

Jack Cronin
Thanks, Jen and good morning everyone. I'm pleased to say that fourth quarter 2021 was a continuation of our strong financial performance. While we came up slightly short in exceeding our third quarter 2021 record results, we believe we are well positioned to continue our growth trajectory in 2022. A major assumption, of course, is if the global markets remain resilient to developments around COVID-19.

Addressing fourth quarter of 2021 financial results, consolidated revenues totaled $59 million representing an organic increase of 21%, compared to $48.7 million in Q4 2020. This revenue performance was $0.5 million lower than our record revenues in Q3 2021, largely due to lower utilization reflective of seasonal holiday and vacation schedules in Q4.

Our Data and Analytic Services segment contributed revenues of $10.1 million, our second consecutive quarter where revenues exceeded the $10 million threshold and represented an organic growth of 13% over last year's revenues.

During Q4, we generated order bookings of $14.4 million in our Data and Analytic Services segment, which included two significant multi-year, multi-million dollar assignment in the healthcare space. Both of these new orders were expected in Q3 but didn't close until late Q4, which did impact our fourth quarter revenues. Additionally, pipeline opportunity continues to show promise as we enter 2022.

In our IT staffing services segment, revenues of $49 million essentially matched our record revenues in Q3 2021 and represented a year-over-year increase of 23%. Activity levels remained elevated in Q4 despite seasonal holiday and vacation disruptions as well as normal high levels of December assignments.

Gross profits in the fourth quarter of 2021 totaled $15.7 million, compared to $13.1 million in the fourth quarter of 2020, an increase of 20%. Gross margins as a percent of revenue in Q4 2021 was 26.6%, compared to 26.8% in the 2020 fourth quarter. This slight margin variance was primarily the result of Q4 2021 having fewer business days in December than Q4 2020 due to the timing of December holiday.

GAAP net income for the fourth quarter of 2021 was $3.9 million, or $0.32 per diluted share, compared to $2 million, or $0.17 per diluted share, in Q4 2020.

Non-GAAP net income for the fourth quarter of 2021 was $4 million, or $0.34 per diluted share, compared to $3.4 million, or $0.29 per diluted share, in the fourth quarter of 2020.

SG&A expense items not included in non-GAAP financial measures net of cash benefits are detailed in our fourth quarter 2021 earnings release, which is available on our website.

Highlighting our full-year 2021 results, revenues were a record $222 million, which were up 14% on a year-over-year basis as both of our business segments achieved double-digit growth.

Consolidated gross margins grew to a record 26.8% for the full-year 2021.

GAAP diluted earnings per share was $1.02, compared to $0.83 in 2020; and non-GAAP diluted EPS was a record $1.19.

Lastly, I do want to say a few words about our financial condition after closing a very successful 2021. During the year, we continue to paydown debt and improve our leverage ratios. This occurred even while we invested nearly $12 million in operating working capital to support our revenue growth and to repay $2.3 million related to the COVID-19 payroll tax deferment program of 2020.

Our days sales outstanding measurement at December 31, 2021 was 61 days versus 60 days a year ago, which we believe is a good position for us given the increase in project business in 2021, which generally carries a higher DSO measurement.

In fourth quarter, we amended our credit facility with PNC Bank, extending our facility term date through 2026, increasing our credit capacity and lowering our cost to borrow. We believe this amendment gives us further flexibility to support our business both on an organic and inorganic basis.

At December 31, 2021, we had outstanding bank debt net of cash balances on hand of $6.5 million, no borrowings under our revolving credit facility, and cash availability of $32.4 million. Our new credit facility also includes a term loan accordion feature, which can provide us with additional term loan capacity of up to another $20 million. Doing the math, we are potentially sitting with access to over $50 million of capital resources today.

I'll now turn the call over to Vivek for his comments.

Vivek Gupta
Good morning, everyone. Thank you, Jack, for the detailed financial review of our operating results for 2021.

Let me start by saying that I'm very pleased with both our Q4 and full-year 2021 financial performance. 2021 was a pivotal year for both of our business segments as we recovered from the effects of the onset of the pandemic in 2020. During the year, we continued to execute on our strategic priorities by deepening new and existing relationships in the markets that we serve. We continue to invest in both SG&A and capital expenditures to expand capabilities and take advantage of the positive trends that we are seeing in both of our business segments.

Notwithstanding some disruptions in economic activity from COVID-19 variants throughout the year, our financial results for 2021 included the achievement of record revenues, record gross margins, and a solid earnings performance. Additionally, we believe a strong 2021 order backlog in our D&A segment and record billing headcount in our IT staffing segment position us well for growth as we enter 2022.

Now, let me share a few of our 2021 operational highlights.

First, our Data and Analytics Services segment. Bookings totaled a record $55 million in 2021, despite experiencing some order delays during the year. Our multi-year, multi-million dollar center of excellence service offering recovered nicely in 2021 after our down year in the pandemic impacted 2020. Additionally, order backlog at December 31, 2021 was at an all-time high, and our pipeline of opportunities continues to show promise. The proliferation of COVID-19 variants continues to be a global macroeconomic concern, but currently these concerns have not appeared to materially impact our clients' willingness to start new assignments. We are looking for improving conditions on the COVID front in 2022.

Our global partnership with IBM showed revenue improvement in 2021 from depressed global activity levels of 2020. Our pipeline of opportunities in the second half of 2021 strongly suggests that this improvement should continue in 2022 at our international subsidiaries.

Our cloud services and customer experience services are ripe with potential as we enter 2022. We are finding good acceptance of these innovative new offerings in the marketplace. Our objective for 2022 is not only to accelerate revenue growth, but to also strengthen gross margins in both of these offerings.

And lastly during 2021, we entered into a new operating lease in Chennai, India. This new lease expands our office capacity to nearly 2x our prior capacity, adds upgraded amenities and modernizes the look and feel of this key D&A delivery center.

Now, looking at our IT staffing services segment. Our record 2021 financial performance and revenues, gross margin, and profitability is the result of some very exciting achievements during the year. We expanded relationships with most of our key clients. We had one of our best years with respect to capturing new logos, and our offshore recruitment center in NOIDA, India strategically expanded staff ahead of the growing demand, and at the same time improved significantly on its productivity metric by fully embracing the work-from-home model. This is a pivotal accomplishment for the recruitment center and one that we believe will improve our business model for years to come.

Our MAS-REMOTE service offering continued to gain traction in 2021, and we have begun expanding this offering to include India-based offshore consultants. We believe customers who have become comfortable with the work-from-home model are now ready to enjoy material cost savings by embracing this offshore staffing model. We are excited about this offerings growth potential in 2022 and beyond.

On a final note, as most of you know, Paul Burton, our Chief Executive of the Data and Analytics Segment, decided to leave Mastech Digital in December. During Paul's tenure with our Company, he did an amazing job of taking our D&A business to the next level in terms of our ability to compete in today's global marketplace. For that, we thank Paul wholeheartedly and wish him the best in his new endeavors.

With respect to our search for Paul's successor, I can tell you that the candidates that we have looked at have been very, very impressive. I feel comfortable saying that we should have a new Chief Executive for the Data and Analytics services business on board in the not so distant future.

This concludes our prepared remarks. Operator, we can take the questions now.

Operator
Thank you. Ladies and gentlemen, at this time we will be conducting a question-and-answer session. If you would like to ask a question, please press "*" "1" on your telephone keypad, and a confirmation tone will indicate your line is in the queue. You may press "*" "2" if you would like to remove your question from the queue. For participants using speak equipment, it may be necessary to pick up your handset before pressing the "*" keys. One moment please while we poll for questions. Our first question comes from Josh Vogel with Sidoti. Please proceed.

Josh Vogel
Thank you. Good morning, Vivek and Jack. Thanks for taking my questions and congratulations on a very impressive 2021. I have a couple here for you. I guess, first start with what expectations should we have for staffing and D&A mix this year, as well as what kind of gross margin expansion we can expect , just the overall gross margin profile of the business going forward from here?

Vivek Gupta
Hi, Josh. It's always nice to hear your voice. As you know, we don't give guidance. So, I wouldn't want to go into specifics, but our plan for the year is to keep the momentum going in both the businesses. There is clearly demand for staffing services and we are trying to maximize what we

can in terms of exploiting that demand to the fullest. And as I said in my, uh, earlier comments, the customers are now more open to signing up for new assignments on the D&A side.

So both the businesses should grow. How will the mix change? It's hard to say at this stage, but we are obviously always looking at ways of improving the gross margins, every year, every quarter. So, again, there should be some improvement, but I wouldn't want to be very specific on that as we don't give guidance.

Josh Vogel
No, I understand. And thank you for those insights. When we look at your bookings number in Q4, how much came from those two significant healthcare assignments that are pushed into the quarter?

Vivek Gupta
Those two, and, Jack, correct me if I get my number wrong, I think they were a little more than $8 million, out of that was from these two orders. Would that be right, Jack?

Jack Cronin
Yes. I think it was a little south of $8 million.

Josh Vogel
Okay, great. And, you mentioned that those are pushed late into the quarter and saw a little seasonality in D&A from Q3 to Q4. I was just curious about how I should think about that business going forward given the demand in bookings pipeline. Is it going to be something like a steady build quarter-to-quarter with some seasonal decline in Q4? And given that there was the later bookings of those healthcare assignments, should we expect to see revenue in the segment and I know you're not giving guidance, but directionally should revenue pick-up in Q1 versus Q4?

Vivek Gupta
Josh, yes, with the healthy order backlog that we have and having signed some new deals, we do expect some sequential improvement in the current quarter, the Q1 quarter. But of course, the intent is to see how we can continue to keep growing and improving quarter-on-quarter. So, yes, that's, I guess, the best I can say at this point in time. Yes, those deals which came in Q4 will definitely be helpful in the future quarters.

Josh Vogel
Great. And you've obviously done a great job protecting pricing throughout the pandemic. And today, I was just wondering if you can share any comments with regard to pricing and the bill pay rates that you're seeing in staffing?

Vivek Gupta
On the staffing side, yes, pricing is something that we have been able to manage quite nicely. But on the other hand, it's also been, the market is, as you know, it's very hot. The demand is far more than supply. So as a result of that, these prices or the build rates are going up across the board anyway to some extent.

So the trick is not to succumb to pricing pressures downwards and at the same time to see how you can benefit from the upward pricing pressure, which is coming in the industry in general. So, yes. It should all be, I guess, it should result in positive outcomes as a result of that.

Josh Vogel
All right. Great. And just last one, and let some others ask. Jack, you mentioned a lot of potential dry powder. Can you talk about capital allocation or deployment strategy for 2022? And also are acquisitions on the table? And if so, would it be geographic? Would it be capability? any thoughts there? Thank you.

Jack Cronin
Acquisitions are a part of our overall strategic strategy for sure. If you notice in our press release, we had some non-GAAP expenses around acquisition transaction expenses. And that was an acquisition candidate that we are looking at spent some due diligence money and backed us. So, clearly, in 2022, we're looking for the right candidate with respect to acquisitions.

Based on the acquisitions that we've done in the past, earn out is a big component of our ability to find an attractive acquisition. So if we're sitting there with, you know roughly $15 million of dry powder that bodes well for the type of acquisition that we can take on.

Josh Vogel
That's helpful. And are you seeing in candidates or you're looking at are valuations still really inflated or are they starting to come down a little bit?

Jack Cronin
You know what, Josh - I really can't, look at the history of some of these spaces that we're looking at right now. But the valuations are on the high end.

Josh Vogel
Understood. Well thanks for taking my questions and again, congrats on a great 2021.

Vivek Gupta
Thanks, Josh.

Operator
Our next question is from Lisa Thompson with Zacks Investment Research. Please proceed.

Lisa Thompson
Good morning. Glad – glad to see things are going so well. First, minor question, how many billable consultants did you end the year with?

Vivek Gupta
Jack, do you have the number handy?

Jack Cronin
I do have the number handy. It's 1,061 –

Lisa Thompson
You knew I was going to ask.

Jack Cronin
I knew you're going to ask.

Lisa Thompson
Once again –

Jack Cronin
1,061

Lisa Thompson
1,061. Well, you said it was record, so I thought you'd want to brag about it.

Jack Cronin
We hit a lot of records in 2021. So we did a lot of bragging.

Lisa Thompson
Yes. Okay.

Vivek Gupta
Lisa, if I may just add to – we added 199 consultants in the year. And we started the year where, if my memory serves me right, something like 1,060 or so. So it's almost a 19% increase in headcount, billable headcount.

Lisa Thompson
1,068. You're good. Do you plan that again for this year or do you want to try to beat that? What's the objective?

Vivek Gupta

We do want to, obviously, keep the momentum going. But, I'm not sure whether 19% kind of growth can happen again in another year because, we shouldn't forget that 2020 we've lost a lot of headcount, and then we were building back. But what's happening is, as the whole year has gone by, a lot of those assignments are coming to end. So now, it's getting more into a business as usual kind of mode where you are going to constantly backfilling the one which are ending and trying to scale at the same time.

So, I think it should still be good. We should still do much better than the industry as we've done for the last so many years. But I don't know whether, you know, 19% kind of headcount growth is going to be practical.

Lisa Thompson
So has anything changed recently? You said – you said business is getting back to normal and staffing. Is the churn going down to back to where things usually are, or is it still crazy attempts to hire?

Vivek Gupta
I think crazy is the right word. It is right now the ends, as we call them are at record level. I mean, but then, we are doing a great job of having starts, which are even greater than the end. So even starts are at a record level as well. And the equation always starts minus ends is equal to net growth.

So to achieve a net growth of 199, we've had unprecedented number of starts, while we are also facing with record number of ends. And I think that kind of environment will continue. So we are constantly trying to gear-up our team, you know, in terms of numbers and productivity, et cetera to be ahead of the curve. And that's the only way we will be able to keep growing. So this ends is not going to come down while the market is still hot. The trick really is to see that our starts far exceed the ends.

Lisa Thompson
And are there any externalities it'll change this? Is it just there's more job openings for IT people than there are IT people? Or is there anything else going on out there?

Vivek Gupta
Well, it’s primarily that. It's also, I think, that businesses are willing to spend more. So, lot of the projects that they had put on hold in, 2020 – and they were being a little cautious in the early part of 2021. I think they are beginning to spend and these projects require more people.

So one is the shortage of people, which we know is there in the country. And on top of that, constantly customers are wanting to do more. And there aren’t people available. And they need the help from, you know, companies like ours. And that's why they're also being much more open to MAS REMOTE. And as I’ve mentioned in my comments, even working out of India, offshore staffing is also becoming something more real for customers because it's very difficult for them to find people.

Lisa Thompson
Okay. So they're kind of making up for lost time in addition to business as usual. All right. So, you talked about you have 50 million in dry powder. AmberLeaf, I guess, didn't quite live-up to its high expectations of what they thought they could do. Are you more gun shy or are you still willing to go after big acquisitions? What's you're thinking now?

Vivek Gupta
Oh, no. We are not gun shy. We are looking at acquisitions, which are kind of in our range. So, the big and small. But at the same time, we're also sort of waiting for the new Chief Executive to come on board because end of the day, any acquisition we do in this year will be, sort of owned and managed by the new leadership.

So sorry, I'm just answering your question by, we are keeping the powder dry. We definitely want to go down that path. But, we're going to just wait for, I guess, a little bit more for the new leader to come in, and then take a call directionally where we are going. But data and analytics definitely is the focus area for any acquisition.

Jack Cronin
Hey, Lisa, I just want to make one comment on AmberLeaf. Clearly, their revenues haven't, performed to expectations, but they're profitable. We like their service offerings. We're still keen on customer experience. So, I wouldn't obtain it as a bad acquisition. And the fact that when they don't make their revenue numbers, even though they still bring in a nice amount of change on the bottom line, you know, essentially, it helps us a little bit because they're not going to make their earn-out. But, yes we're going to enjoy –

Lisa Thompson
– Right –

Jack Cronin
Some nice bottom-line profitability. And again, we're still keen on the service offering.

Lisa Thompson
Yes, of course. Great. That's why that earn out so wise to put into the full acquisition. Great. So, and one other thing. On the healthcare customers that you just signed, are they already generating revenue? Does that happen in the day they sign? How does that work?

Vivek Gupta
Yes. They've already started bringing revenue. And I think one of them was already an existing customer so we kind of signed a large deal with an existing one. And the other one is a new customer and they both started billing.

Lisa Thompson
All right. Great. So one other thing. You kept talking about improving margins and data analytics and getting AmberLeaf's margins up. Are you there now at steady state where you pretty much got them to where they're going to go?

Vivek Gupta
No.

Jack Cronin
No. I mean they still had improvement to be made. I mean, they've improved from where they were when we took over, but they're not – they're not close to, um, our core D&A margins. There's still some upside that we see.

Lisa Thompson
All right. That's great. Okay. Sounds good. I think that's all my questions. Thank you so much.

Jack Cronin
Thank you, Lisa.

Vivek Gupta
Thanks, Lisa.

Operator
Our next question is from Timothy Call with The Capital Management Corporation. Please proceed.

Timothy Call
Congratulations on such strong bookings. Seasonally, is it odd to experience such strong bookings in the fourth quarter?

Vivek Gupta
Sorry, your voice broke up. Could you just repeat the last sentence?

Timothy Call
Is it odd to experience strong bookings in the fourth quarter from a seasonal standpoint?

Vivek Gupta
Well, it's not odd. But, yes, it's happy news, yes. Bookings sometimes seasonally bookings tend to be a little less in Q4 and then pick up in Q1 but, yes, probably the sign of the sales engine firing well.

Timothy Call
Did having fewer days in the fourth quarter negatively affect revenue versus last year?

Jack Cronin
Yes, it affected revenue, and it also affected gross margins. And that extra holiday, if you will, in 2021 was, you know, the recognition of the holiday around New Year's, because the New Year holiday is generally in January. This year because of the holiday being on a weekend, the celebration of it was December 31.

So, there was a higher benefit load in, you know, December 2021, compared to 2020. And the good news is, in Q1, it will just be the reverse. We'll have one less holiday in Q1 that we normally have. Did that make sense?

Timothy Call
Yes, yes, it does. Given the strong global demand for new product offerings, including cloud services are you in a position to handle continued large increases in customer signings?

Vivek Gupta
Yes, we've spent a lot of time and effort and money last year in building our capabilities in the various areas of our portfolio of offerings. And cloud services is definitely one of them. And, yes, we are able and willing. And we are actively marketing those offerings. So the answer is yes.

Timothy Call
Well, congratulations on the strong orders and being prepared for to take advantage of what you've built. Good job.

Vivek Gupta
Thank you.

Jack Cronin
Thank you.

Operator
Thank you. As a reminder, if you would like to ask a question, please press "*" "1" on your telephone keypad and a confirmation tone will indicate that your line is in the queue. Ladies and gentlemen, there are no further questions at this time. I would like to turn the call back to – to Vivek Gupta for any closing remarks.

Vivek Gupta
Thank you, operator. So if there are no further questions, I would like to thank everyone for joining our call today. And we look forward to sharing our first quarter 2022 results with you in late April. Thank you.

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