

Q1 Earnings Conference Call

April 26, 2018

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**MASTECH DIGITAL, INC.**  
**Q1-2018 Earnings Conference Call**  
**April 26, 2018**  
**Confirmation #13679100**

**Operator:** Greetings, and welcome to Mastech Digital, Inc. Q1 Earnings Conference Call. At this time all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference please press star zero 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 First Quarter 2018 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](http://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 our 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 2017 annual report on Form 10-K filed with the Securities and Exchange Commission and available on its website at [www.sec.gov](http://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 our

business. Reconciliations of these non-GAAP financial measures to their comparable GAAP measures are included in our earnings announcement, which can be obtained from our website at [www.mastechdigital.com](http://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 first quarter 2018 results.

**Jack Cronin:** Thanks, Jen, and good morning, everyone.

Revenues for the first quarter of 2018 totaled \$43.3 million and represented a 31% increase over the first quarter of 2017.

Our Data and Analytics Services segment, which was acquired on July 13, 2017, contributed \$6.6 million of revenue in Q1 2018, which was \$1.5 million or 28% higher than revenues reported from this segment in the fourth quarter of 2017. This sequential revenue increase reflected strong activity levels and several project wins during the quarter.

Our IT Staffing Services segment had year-over-year organic revenue growth of 11% in the first quarter of 2018, as our billable consultant base increased by 13% over the last 12-month period. Demand for our IT Staffing Services remained robust during the first quarter of 2018, and we were able to expand our billable consultant base by 3% at March 31, 2018, from our year-end 2017 position.

Gross profits for the first quarter of 2018 totaled \$10.3 million and represented a 65% increase compared to \$6.2 million in the same period last year.

Our gross margins for Q1 of 2018 were 23.7% of revenues compared to 18.8% in the first quarter of 2017 and 23.5% in Q4 2017.

Our Data and Analytics Services segment had gross margins of 44.3%, which was down from 45.3% that we reported in Q4 of 2017. This decline was due to higher bench costs, as we invested in expanding practice capabilities and securing hard-to-find resources for future engagements.

Our IT Staffing Services segment had first-quarter gross margins of 20% compared to 18.8% in Q1 2017. Given the higher payroll tax load that historically occurs in Q1, we're very pleased with this 20% margin performance. The improvement from the corresponding quarter last year reflected higher direct hire revenues and higher margins on new assignments, largely those deploying advanced technology skill-sets.

SG&A expenses were \$7.8 million in the first quarter of 2018 and represented 18.1% of revenues compared to \$5.8 million or 17.5% of revenues in Q1 2017. Exclusive of the amortization of acquired intangible assets, our operating expenses as a percentage of revenues were 16.5% in Q1 2018 compared to 16.9% in Q1 of 2017.

GAAP net income for Q1 2018 was \$1.4 million or \$0.25 per diluted share compared to \$201,000 or \$0.04 per diluted share in the first quarter of 2017.

Our non-GAAP net income for Q1 2018 was \$2 million or \$0.36 per diluted share compared to \$394,000 or \$0.09 per diluted share in the corresponding quarter of 2017.

First-quarter SG&A expense items not included in non-GAAP financial measures, net of tax benefits were the amortization of acquired intangible assets and stock-based compensation and are detailed in our first-quarter earnings release, which is available on our website.

Addressing our financial position, at March 31, 2018 we had approximately \$38 million of outstanding bank debt net of cash balances on hand, and our borrowing availability was \$13.5 million under our existing revolving credit line.

At the end of last week, we took what I would call proactive steps to amend our credit facility. The desired results were to increase our financial flexibility, lower our bank fees and improve the mechanics of how we manage our cash balances. To that end we executed an amendment, which is further described in our Form 8-K filed with the Security and Exchange Commission yesterday. The amendment, 1), adjusted our senior leverage ratio through Q3 of 2019, which will give us more flexibility during the two-year earn out periods related to our InfoTrellis acquisition. 2), it reduces our revolving credit line by \$5 million to \$22.5 million, which will lower our unused line fees and still give us adequate availability. And 3), the amendment will increase our swing line by \$5 million to -- or excuse me -- increase by \$2 million to \$5 million, which will improve our cash management efficiencies. I do want to stress that as of March 31,

2018, without the provision of this amendment, we were still in full compliance with all covenants under the credit facility.

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 Q1 2018, clearly an exciting quarter for Mastech Digital.

I'm very encouraged by our performance and our growing ability to capitalize upon the opportunities that lie ahead. First-quarter results support our belief that our recent management focus and continued investment in our business are well-founded.

Our first-quarter 2018 financial results and accomplishments were positive in both of our business segments.

Data and Analytics Services continued to see strong pipeline demand for its services. We secured a number of exciting projects during the first quarter, and despite some historical lumpiness in the business we were able to expand revenues for the second consecutive quarter by close to 30%. As Jack mentioned, our gross margins were down somewhat from Q4 2017

results, which reflected investment initiatives in enhancing several practice capabilities within our big data and master data management service offerings.

In April 2018, we have upgraded and expanded our global delivery center in Chennai, India, which will give us the ability to nearly double our manning capacity from existing levels. This new facility provides our offshore delivery organization with state of the art infrastructure and workforce amenities to attract top quality talent. Additionally, we continue to look to expand and upgrade our sales organization, an initiative that started in earnest in Q4 of 2017.

Our IT Staffing Services business also had a very nice first quarter of 2018. On a year-over-year basis revenues grew by 11%, all organically. Gross margins improved by 120 basis points, and our segment operating income increased from \$606,000 in Q1 of 2017 to \$1.4 million in Q1 of 2018.

Activity levels remained robust in Q1 2018, and operationally we are seeing improvement in recruitment effectiveness, largely from investment initiatives that we made during 2017. This improvement has allowed us to secure more assignments with advanced technology skill sets while at the same time lower our recruitment cost structure as a percentage of overall revenues.



During the first quarter 2018 we added to our billable consultant base 30 consultants, or about 3% from our headcount at December 31, 2017. The topline growth is occurring through expansion of business with existing clients as well as by securing some very prominent new logos.

Overall, morale is very high and creativity is blossoming throughout the entire Company as employees are empowered to change -- to challenge the status quo.

In summary, I feel very good about the quarter that we delivered, the quality of talent that we have at our disposal at Mastech Digital today and the prospects for the future.

I will now open the session for your questions.

**Operator:** Thank you. At this time we'll be conducting a question-and-answer session. If you'd like to ask a question please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you'd like to remove your question from the queue. For participants using speaker equipment it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we poll for questions. As a reminder, if you'd like to ask a question please press star one on your

telephone keypad. One moment, please, while we poll for questions. Our first question is from Bill Sutherland with The Benchmark Company. Please proceed with your question.

**Bill Sutherland:** Hey, good morning, and thanks for taking the question. I was impressed with the quarter-over-quarter growth for Data and Analytics and just curious how we should be thinking about that group going forward, whether that kind of pace is in the picture, or is that a situation that's more lumpy? Thank you.

**Vivek Gupta:** Bill, this is Vivek here. First of all, I should say that we don't give guidance, so I would not like to make a statement as to what the future looks like, but as I said in my piece that we are very encouraged by the way the pipeline is building and the kind of projects that have come our way. We've been able to get some new projects from existing customers. We've also been able to add some new logos into the mix. It's an encouraging trend, but there is the lumpiness in the business because it's a very project-based business, which means projects could be taking off in one quarter projects -- many projects could be coming down in a specific project. There would be some lumpiness in that, so we must factor that in, as well, while we look at the robustness of the pipeline.

**Bill Sutherland:** What is the average project duration at this point?

**Vivek Gupta:** Typically, it would be 6 to 9 months.

**Bill Sutherland:** Okay. I don't know if I've seen kind of what your main sector focuses are in this business line in the Data and Analytics.

**Vivek Gupta:** I didn't quite get your question. When you say main sectors, are you talking about --

**Bill Sutherland:** So, the end markets that you all principally serve in your Data and Analytics group.

**Jack Cronin:** I mean, the end markets as in vertical industries, or

**Bill Sutherland:** Yes.

**Vivek Gupta:** Oh, okay. So right now we are not organized on vertically, we are addressing essentially and are most focused geographically, and in the process we are working with customers from all industry verticals. But there tends to be a lot more business coming from the financial services and insurance segment from the healthcare side and retail. But that's

more, I don't want to say by accident than by design. I mean, we are not really actively going doing the vertical focus. But maybe we will get there over a period of time.

**Bill Sutherland:** Okay. And then last one for me is if you could speak to your plans for capital deployment going forward. Thanks.

**Vivek Gupta:** Bill, can you, -- sorry -- repeat the question?

**Bill Sutherland:** On capital deployment, what are your priorities, as you look at your uses of cash and what you expect to generate?

**Jack Cronin:** I think, let me take a stab at that, Bill. I think that we're looking to make investments but short of organic-driven investments. We're looking to expand some of the Data and Analytics capabilities. Strengthen what we have on the IT Staffing side. But I think at least in the near term, we're not looking to do any significant acquisitions.

**Bill Sutherland:** Okay. Thanks again.

**Jack Cronin:** Thank you.

**Operator:** As a reminder, if you'd like to ask a question please press star one on your telephone keypad. One moment, please, while we poll for questions. There are no further questions at this time. At this point I'd like to turn the call back to Vivek Gupta for closing comments.

**Vivek Gupta:** Thank you, operator. If there are no further questions I would like to thank you for joining our call today, and we look forward to sharing our second-quarter 2018 results with you in late July or early August. Thank you.

**Operator:** This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.