

MASTECH DIGITAL, INC. Q3 2016 Earnings Call

October-26-2016

Confirmation #13648457

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Operator: Greetings and welcome to the Mastech Digital's Q3 2016 Earnings Call.

At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star then 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. Thank you Ms. Ford Lacey. You may now begin.

Ms. Jennifer Ford Lacey: Thank you, operator and welcome to Mastech Digital's third quarter 2016 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 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 2015 Annual Report on Form 10-K filed with the Securities and Exchange Commission and available on their website at www.sec.gov.

Additionally, management has elected to provide 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.

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 third quarter 2016 results.

Mr. Jack Cronin: Thanks, Jen, and good morning, everyone. Revenues for the third quarter of 2016 totaled \$34.3 million compared to \$34.6 million in the third quarter of 2015. This revenue performance represented a 2 percent sequential increase over second quarter 2016's revenue results.

Activity levels during the quarter were in line with the previous quarter. However, assignment ends were 25 percent higher in the third quarter of 2016 when compared to the second quarter of 2016. Thus, we had a 3 percent decline in our billable consultant base compared to a 7 percent expansion in the previous quarter.

Gross profit for the third quarter 2016 totaled \$6.9 million, which was in line with the same period last year. Our gross margins for the third quarter of 2016 were 20.1 percent of revenues and represented a 20 basis point improvement compared to the corresponding period of 2015.

This year-over-year gross margin improvement was largely due to higher gross margins on new assignments, partially offset by lower direct hire fees.

SG&A expenses were \$5.3 million in the third quarter of 2016 and represented 15.5 percent of total revenues compared to \$5.4 million or 15.5 percent of revenues in the third quarter of 2015.

GAAP net income for the third quarter of 2016 was \$924,000 or 21 cents per diluted share compared to \$887,000 or 20 cents per diluted share in the third quarter of 2015. Non-GAAP net income for Q3 2016 was \$1.1 million or 25 cents per diluted share, compared to \$1.1 million or 25 cents per diluted share in the corresponding quarter of 2015.

SG&A expense items not included in non-GAAP financial measures net of income tax benefits were, one, the amortization of acquired intangibles, two, stock-based compensation, and three, 2015 acquisition transaction expenses and are detailed in our third quarter earnings release, which is available on our website.

Addressing our financial position, at September 30th, 2016 we had \$15.3 million of outstanding bank debt net of cash balances on hand, and our borrowing availability approximated \$8 million under our existing revolving loan facility. Our largest asset, accounts receivable, remains a very high quality, and our day sales outstanding measurement at quarter-end improved to 58 days.

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

Mr. Vivek Gupta: Thank you, Jack, and good morning, all. I'm pleased to report that we continue to make good progress in the ongoing transformation of Mastech into a digital technologies company. Externally during the third quarter, we rebranded our company, which included our name change to Mastech Digital, a new logo and the launch of a refreshed corporate website. Internally, we continue to add new talent to our sales and recruitment teams, which will allow us to better service our clients' digital transformation needs, including the provision of digital and mainstream IT staffing services.

As Jack mentioned, from a financial perspective, revenues in the third quarter of 2016 showed a 2 percent sequential improvement over the second quarter of 2016, and our bottom line results were solid and largely in line with last quarter's performance. Additionally it is worth noting that digital technologies accounted for 20 percent of our overall revenues in the third

quarter of 2016. We expect to see this percentage increase over time as our transformation efforts gain traction.

While Mastech Digital's transformation into a broader digital technology solutions company will not happen overnight, we continue to make good progress, both internally and externally, in positioning our company to facilitate this ultimate objective.

I will now open the session for your questions.

Operator: Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, then one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would 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 while we poll for questions.

Once again, if you would like to ask a question, please press star, then one.

Our first question today comes from David Polonitza of AB Value Management. Please go ahead.

Mr. David Polonitza: Hey, good morning, gentlemen.

Mr. Vivek Gupta: Good morning.

Mr. David Polonitza: You mentioned 20 percent of the company's revenue is now digital technologies--is this new revenue or is this a revenue trend that the company already had but now you're focusing on under the digital technologies umbrella?

Mr. Vivek Gupta: Hi Dave. Nice to hear from you. This 20 percent of our revenues naturally kind of happened in the sense that we're already servicing all different technologies including the mainstream and the digital technologies. So, this is mostly because of ongoing efforts, and it's not really because of the new initiatives that have been put into place so far.

Mr. David Polonitza: Sure. Could you elaborate on some of those new initiatives? I know you took some big steps with rebranding the company and a lot of changes externally, but internally

to the company, how over the last few months, since you've been on board have you focused on this area differently than in the past?

Mr. Vivek Gupta: Sure, Dave. When it comes to our service offerings we've been operating as a sort of a general all technologies staffing--IT staffing company. So, one of the first things that we have done is to introduce special focus on servicing the staffing needs of our customers in the digital technologies area.

We've put together a practice. We've hired recruiters who are dedicated to servicing the digital technologies and that's as far as the staffing part is concerned. We've ventured into the digital transformation services area and that is currently comprising three main elements. The first one is a practice that we have built for salesforce.com. In fact this practice was already there before I came on board six months ago, but we have energized that practice and we've been able to venture into even doing projects, although a small project is where we've made a beginning there.

The second area is getting--building a practice around SAP HANA because we saw that there is a huge opportunity in that space where customers are moving from whatever they have in the SAP world into the new SAP HANA world, which is also the area of analytics for SAP, and the

third area is really our learning and performance practice. We have morphed that into a digital, learning practice.

So, these are the three new initiatives or new areas that we are focusing on, as we go forward over the next few quarters. We'll be looking to see how we can expand this portfolio of services and, service the larger needs of our customers in the digital transformation space.

Internally, we've broadened our marketing team, a full marketing function, which wasn't there before I came on board, and they've done an incredible job of doing the branding, helping us select the name, the logo, the website. Our social handles are all very active at the moment, and, we've had good response from the market about the name change. It kind of clearly gives the direction message to the market as to the direction in which we are heading.

The other thing that we did was we revamped our HR department. It was there, but it was in some ways fragmented. So, we've consolidated that and we're happy to have a very good HR head on board. So, that's the other aspect.

And the third one is, as I mentioned a little earlier when I was speaking, we focused on looking at the sales and the recruitment function, and we've added new talent in that space and some

of the folks that we've added on the sales side are people who are able to sell their digital services, or who come to the experience of selling the digital services.

Likewise on the recruitment side, we've added more recruitment capacity, and again, we've looked at, as we were hiring people to bring in recruiters who come with the experience of having operated in the digital technologies world.

This broadly is some of the things that we've done. Does that answer your question, Dave, or is there anything else that you would like me to talk about?

Mr. David Polonitza: Well, that answers my question. The one other aspect -- how is the sales process different compared to how the company operated simply as a traditional staffing business versus what you're trying to do in today's environment? Obviously, there's probably a very different sales approach that you have to take.

Mr. Vivek Gupta: Well, Dave, the sales approach is not very different because I know it's back to Sales 101. We really are trying to connect the dots as far as our customers' requirements are concerned, because we have practices and we subject matter experts in some of the digital transformation technology areas, we are trying to understand our customers'

requirements a little better and proposing whatever is the right solution in the digital world, so whether it is staffing or even doing projects or doing them on a managed services way, it requires a different kind-among the sales folks, it needs a little bit of training for them to be able to in a consultative way rather than the traditional way that we've been doing, and we've been focusing a lot on that. We are looking at the connects that we have with our various customers and again, as I said, Sales 101 in terms of better account management, better relationship management. I wouldn't say it's a radical change, but it's an incremental change, which we have introduced because our main offering still continues to be staffing. Now we have an additional focus on the digital technologies.

Mr. David Polonitza: Great. Thank you.

Operator: Once again, if you would like to ask a question, please press star then one on your touchtone telephone.

There appears to be no further questions at this time. I would like to turn the floor back over to Vivek Gupta, CEO of Mastech Digital, for closing comments.

Mr. Vivek Gupta: Thank you, operator. If there are no further questions, I would like to thank you all for joining our call today, and I look forward to sharing our fourth quarter 2016 results with you in early February. Thank you very much.

Operator: This concludes today's teleconference. You may now disconnect your lines. Thank you for your participation.