

Mastech Digital Inc. Q1 2017 Earnings Call

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Confirmation #13660624

Page 1



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Operator: Greetings, and welcome to the Mastech Digital, Inc. Q1 2017 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 turn over to your host, Jennifer Ford Lacey, Manager of Legal Affairs for Mastech Digital. Thank you, Ms. Ford Lacey. You may begin.

Ms. Jennifer Ford Lacey: Thank you, operator, and welcome to Mastech Digital's first quarter 2017 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 2016 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 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 first quarter 2017 results.

Mr. Jack Cronin: Thanks, Jen, and good morning, everyone. Revenues for the first quarter of 2017 totaled \$33.1 million and represented a 4.4 percent improvement over revenues of \$31.7 million in the first quarter of 2016. Our activity levels were solid and showed some improvement over the previous quarter, and accordingly, we were able to increase our global consultant base.

Gross profit for the first quarter of 2017 totaled \$6.2 million compared to \$6.1 million in the same period last year. Our gross profit margins for the first quarter of 2017 were 18.8 percent of total revenues and represented a 50 basis points decline compared to the corresponding period of 2016.

The year-over-year gross margin percentage decline was largely due to two factors – 1) higher benefit costs in the 2017 period compared to the first quarter of 2016, which related to less favorable medical claim experience associated with our self-insured healthcare program, and 2), we had some margin declines at an existing integrator client.

SG&A expenses were \$5.8 million in the first quarter of 2017 and represented 17.5 percent of total revenues compared to \$6 million or 18.8 percent of revenues in the first quarter of 2016. It should be noted that SG&A expenses in the 2016 period included approximately \$0.8 million of severance costs related to the exit of several senior executives. Excluding severance costs in the 2016 period, SG&A expenses actually increased by approximately \$0.6 million as the company significantly increased its investment in sales and recruitment in the 2017 period when compared to the previous year.

GAAP net income for the first quarter of 2017 was \$201,000 or 4 cents per diluted share compared to \$11,000 or 0 cents per diluted share in the first quarter of 2016. Non-GAAP net income for the first quarter of 2017 was \$394,000 or 9 cents per diluted share compared to \$692,000 or 16 cents per diluted share in the corresponding quarter of 2016.

First quarter SG&A expense items not included in non-GAAP financial measures net of income tax benefits were, 1), amortization of acquired intangible assets, 2), stock-based compensation, and 3), severance cost in the 2016 period that are detailed in our first quarter earnings release, which is available on our website.

Briefly addressing our financial position at March 31, 2017, we had \$12.4 million of outstanding bank debt net of cash balances on hand, and our borrowing availability approximated \$9.6 million under our existing revolving credit facility. Our accounts receivable balance at quarter-end remains at top quality. Additionally, our days sales outstanding measurement was a healthy 58 days at March 31, 2017.

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

Mr. Vivek Gupta: Good morning, everyone. Thank you, Jack, for the detailed financial review of our operating results. Let me supplement that narrative with a few comments and observations reflective of our first quarter 2017 financial results and operational performance.

Despite the seasonal sluggishness in early January, activity levels picked up nicely during the balance of the quarter. Given the political uncertainty that presently exists in the U.S., this was a welcoming development. Accordingly, we were able to expand our consultants on billing during the quarter to 893. This count is an increase of 39 over the consultant base of 854 at the end of first quarter 2016.

Revenues in first quarter 2017 grew to \$33.1 million from \$31.7 million in the first quarter of 2016. Additionally, our average bill rate increased to \$75.40 per hour in the 2017 period compared to \$74.80 per hour a year earlier. The increase in average bill rate not only favorably impacted our revenues, it also reflects our success in growing the digital technologies portion of our business which in first quarter increased to approximately 24 percent of our total revenues. As a point of reference, digital technologies represented 18 percent of revenues when I joined the company in March 2016. Thus, our journey towards becoming a digital technology services company is progressing well.

From a profitability standpoint, despite slightly higher gross profits in first quarter 2017, our earnings were clearly impacted by several decisions that we made over the last couple of quarters with respect to our operating cost structure. Strategically, these investments for the future decisions were made with a focus on the benefit to the business from a longer term perspective and not from this quarter-only perspective.

We elected to increase our spend on marketing initiatives and have expanded and upgraded our sales organization significantly. We've also increased the deployment of technical resource managers, which have proven to be an effective resource in supporting our sales efforts and interacting with our clients regarding their technical staffing needs.

On the recruitment front, we also made some meaningful investments in our management capability, both domestic and offshore, and have significantly increased our SG&A spend on offshore staff expansion and capability enhancements.

To quantify, our sales and marketing expenses increased in the first quarter of 2017 by approximately \$300,000 from a year earlier, and our recruitment and HR expenses increased by about the same amount during that period. These additional operating costs impacted Q1 2017 profits and will likely, albeit to a lesser extent, impact the next several quarters, as well.

In the longer term, our desired payback on these investments is to accelerate overall growth and to secure the right talent required to continue our journey towards becoming a digital technology services company.

I will now open the session for your questions.

Operator: Thank you sir. We will now be conducting a question-and-answer session. If you would 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 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 please while we poll for questions.

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

As a final reminder, if you would like to ask a question, please press star, then one.

There appears to be no questions. I'll turn the conference back over to today's presenters to have closing comments.

Mr. 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 2017 results with you in late July.

Operator: This concludes today's teleconference. You may disconnect your lines at this time.

Thank you for your participation.