Mastech Digital
Third Quarter 2023 Earnings Call
November 1, 2023

Operator
Greetings, and welcome to the Mastech Digital Q3 2023 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 “*”, “1” 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. Lacey Ford. You may begin.

Jennifer Lacey
Thank you, Operator, and welcome to Mastech Digital's Third Quarter 2023 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; Jack Cronin, our Chief Financial Officer; and Michael Fleishman, our Chief Executive Officer of the company's data and analytics services business segment.

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 2022 annual report on Form 10-K filed with the--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, 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 2023 results.

Jack Cronin
Thanks, Jen, and good morning, everyone. Our third quarter 2023 financial results continue to be impacted by economic uncertainty and our current and prospective clients' responses to these challenging market conditions. Third quarter revenues totaled $47.8 million, representing a 24% year-over-year revenue decline. Both of our business segments contributed to this decline.

Our Data and Analytics Services segment reported revenues of $8 million in Q3 2023, compared to $10.1 million in 2022 third quarter, as customers continued to reduce resources on existing projects and order bookings experienced delays in signing new projects, during the quarter.

Q3 2023 revenues in our IT Staffing Services segment totaled $39.8 million, compared to $53.1 million in the third quarter of 2022. Demand continued to be soft in Q3 2023, as our global consultants declined during the quarter, albeit at a slower rate than experienced in the previous two quarters.

Consolidated gross profit as a percent of revenues in Q3 2023, improved to 26.3%, compared to 25.8% in the third quarter of 2022, resulting in our best gross profit performance, over the last five quarters.

In our Data and Analytics Services segment, gross profit as a percentage of revenue improved significantly, over Q3 of 2022. This improvement reflected higher utilization in the 2023 quarter and the impact of a $300,000 project cost overrun in the third quarter of 2022.

In our IT Staffing Services segment, gross margins were down 80 basis points, compared to the third quarter of 2022, largely due to year-over-year reductions in our direct hire revenues. Generally, contract gross margins held up well when compared to last year despite challenging market conditions.

GAAP net income for Q3 2023 was $125,000, or $0.01 per diluted share, compared to $2.4 million, or $0.20 per diluted share, in Q3 2022.

Non-GAAP net income for the third quarter of 2023 was $1.3 million, or $0.11 per diluted share, compared to $4 million, or $0.33 per diluted share in the third quarter of 2022.

Our third quarter non-GAAP 2023 net income and earnings per diluted share results were in line with last quarter's numbers, despite lower revenues.

SG&A expense items not included in Q3 2023 non-GAAP financial measures, net of tax benefits for stock-based compensation and the amortization of acquired intangible assets. A description of non-GAAP items for all periods presented is included in our third quarter 2023 earnings release, which is available on our website.

Addressing our financial position on September 30, 2023, we had approximately $16 million of cash balances on hand, no bank debt outstanding and borrowing availability of $25 million, under our revolving credit facility. Our days sales outstanding measurement was 55 days at quarter end, which is much better than our targeted range of 60 to 65 days and one day better than our DSO measurement a quarter ago.

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

Vivek Gupta
Thank you, Jack. Good morning, everyone. Uh, the same macroeconomic headwinds that we experienced during the first half of 2023 continued to impact our client spending dynamics in the third quarter, resulting in a lower demand for our services.

Our IT staffing services segment continued to see clients taking a more conservative approach with respect to spending on new projects and new initiatives. Our Data and Analytics Services segment was also impacted by clients reducing resources on existing projects and delaying project starts on new orders. Michael will discuss our order booking performance and prospects in his prepared remarks.

While recent growth in domestic GDP is a positive data point for the U.S. economy, the recent conflict in the Middle East is yet another geopolitical event that has created additional uncertainty in the global economy.

We are continuing to, aggressively, pursue steps to reduce our SG&A expenses as a mitigating action in these uncertain economic conditions. Our operating expenses totaled $12.6 million in the third quarter of 2023, which is a reduction of approximately $800,000 from the previous quarter.

Let me reiterate that we believe that our company remains on a sound financial footing with a solid balance sheet, access to $25 million of capital under our credit facility and long-standing relationships with several top companies in the world. I'm confident that both of our businesses will strongly recover when the market conditions improve.

Let me now turn the call over to Michael for his comments related to our Data and Analytics Services segment. Over to you, Michael.

Michael Fleishman
Thanks, Vivek, and good morning, everybody.

As Vivek mentioned, uncertain economic conditions are clearly impacting our clients' spending behavior, as we continue to see clients reducing resources on existing projects.

While activity levels in our pipeline of opportunities remained elevated during the third quarter, project award delays resulted in a disappointing bookings performance of $5.1 million in the third quarter as clients and prospects implemented tighter expense controls. There is a bit of good news, however, since two sizable projects that were scheduled to commence in Q3 2023, as well as various additional smaller Q3 projects, all of which total approximately $3.5 million, have been awarded in October of 2023, this past October.

Behind our financial numbers, we believe we are making good progress in transforming our organization from a master data management firm to a much broader data and analytics company with capabilities around the entire suite of data modernization services. In this regard, our pipeline of opportunities continues to broaden with data modernization assignments constituting a higher percentage of our 2023 bookings and pipeline versus master data management, when compared year-over-year.

Also, in the third quarter of 2023, we continued to expand our gross margins to 45.8%, which increased 620 basis points over Q3 2022 gross margins. We believe a predictable utilization rate is a key component to our gross margin improvement in 2023 and is a point of emphasis by our delivery teams. This emphasis, coupled with tighter execution processes on our delivery, are giving rise to increased margins, year-over-year.

In closing, I would like to say that I agree 100% with Vivek's belief that our financial foundation is strong and that both of our business segments are poised for growth once more clarity in the global economy occurs.

I'll now turn the call back over to Vivek.

Vivek Gupta
Thank you, Michael. Operator, this concludes our prepared remarks. We can take questions now.

Operator
Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press “*”, “1” on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press “*”, “2”, 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.

Our first question comes from the line of Lisa Thompson with Zacks Investment Research. Please proceed with your question.

Lisa Thompson
Good morning.

Vivek Gupta
Hi, Lisa.

Lisa Thompson
So all right. So I have a few questions. First off, did you buy back any stock this quarter?

Vivek Gupta
We did not. Jack, can you comment on this?

Jack Cronin
Sure, we extended our blackout period for Q3. And the reason behind that is we had an outstanding employment claim that was settled in Q3, and we didn't buy shares during that negotiation period. But, clearly, we think our share price is great value relative to the businesses’ intrinsic potential, and you're likely to see us buy shares in the fourth quarter.

Lisa Thompson
All right. Sounds good, which leads to the second question. What happened with the claim, and why is it still on the balance sheet? Are you going to get paid for that? Or how is that working?

Jack Cronin
Yes, the claim is settled. It's a confidential settlement. It was settled at the economic terms and conditions that we reported in the second quarter. You'll see, if you looked at the balance sheet, you would see that we still have $2.2 million of insurance recovery that is expected to happen within the next 30 days. So, that will generate some additional cash flow for us. But the agreement is finalized and it's settled.

Lisa Thompson
Okay. Good. And what quarter, what expenses did you have for that besides the actual payment, like lawyers?

Jack Cronin
For the claim, we were fully reserved in second quarter. We did have a couple of hundred thousand dollars of legal expense. But as far as the claim that was all reserved in Q2 of 2023.

Lisa Thompson
Okay. So maybe I could take $200,000 off next quarter's expenses because of the lawyers.

Jack Cronin
Yes

Lisa Thompson
Okay. All right. That's good stuff. And then as far as the contracts that you signed in Data and Analytics, you said $3.5 million, I guestimate that's a 1-year contract. Is that additional revenue going to just replace what you're losing, or is that going to be adding to revenue, sequentially?

Michael Fleishman
Vivek, if that's okay with you, I'll take that one.

Vivek Gupta
Yes, I was going to pass it on to you, anyway. Yes, go ahead.

Michael Fleishman
Thanks. Lisa, great questions. It's a combination of someone years, there are a couple of multiyear contracts in there. There's multiple contracts in that $3.5 million over five. Two of them were decent sized as in $1 million-plus, and one of those was a multiyear contract. One of the large ones was from a new logo. I can't disclose the name of the account, but it was a new logo and it was north of $1 million. That is a 1-year, and so we will see all of that revenue in 2024, and it's a new logo, so it's net new revenue to the business, not just continuance and carryover. One of the other larger sizable ones was a renewal, but a multiyear renewal and that revenue will continue, but that account, we feel has growth potential. And then, the other accounts were all net new or expansion on existing accounts. Does that answer your question?

Lisa Thompson
Except for the part where I asked would that mean that you'll have sequentially increasing revenues, netting all that out?

Michael Fleishman
With all of them except for one, for those deals that closed because one of them was a linear renewal.

Lisa Thompson
Right.

Michael Fleishman
So the revenue will be flat year-on-year for that one opportunity that closed.

Lisa Thompson
--Right.

Michael Fleishman
All of the other opportunities that closed in October were sequential growth for 2024 or for 2023.

Lisa Thompson
Okay, and they would compensate for anything you might have lost, right?

Michael Fleishman
Yes. That is correct. Yes, that is a correct statement.

Lisa Thompson
Okay. Alright, good. That's a great sign. Thank you. That's all the questions I have.

Vivek Gupta
Thank you, Lisa.

Operator
Thank you. As a reminder, ladies and gentlemen, if you would like to ask a question, please press "*", "1" on your telephone keypad. Our next question comes from the line of Marc Riddick with Sidoti & Company. Please proceed with your question.

Marc Riddick
Good morning, everyone. I wanted to just start maybe if you can bring us up to date on just a couple of things to fill in on. Where did we finish on the quarter on head count and maybe you could give us a utilization update?

Vivek Gupta .
Sure. Marc. Again, for that number, I'll ask Jack to answer the headcount/

Jack Cronin
The staffing billable consultant, and that's a number that we publish in the Q every quarter, it was 992 billable consultants. And that was down, 49 consultants from the previous quarter. Well, I don't want to say the previous quarter from the beginning of the third quarter, but that loss was, you know, materially better than what we experienced in Q1 and Q2 of 2023. So, there is some hope and improvement in that number.

Marc Riddick
Okay. And then could you share anything on utilization and maybe bill rates, as well?

Jack Cronin
Yes, In staffing, our bill rate was relatively flat from the last quarter. It was a little over $20--or -$80 per hour, a little over that and was pretty close to being flat from the second quarter number. Utilization is, you know, a number that's very, very important data and analytics. As far as the utilization on the staffing business it's generally a pay an hour-bill in hour.

Marc Riddick
Right.

Jack Cronin
And so, utilization is less important in that business. But, our margins have improved dramatically in the D&A business, and a lot of that has been improved utilization. So I think our utilization, and Michael, you can correct me if I'm wrong, we're approaching 80%--we approached 80% in Q3 of 2023.

Michael Fleishman
So yes, that is correct. Our utilization has continued to be a very heavy focus for us in 2023. Our utilization has improved right around 17% since January of this year through October end. We have a forecast target for the year of about 75% utilization for the year is our current target with a pretty decent level of confidence.

Marc Riddick
Okay. that’s helpful. Thank you. And I was wondering if you could talk a little bit in prepared remarks, there was commentary around efforts to look to reduce SG&A and I was wondering if you could provide a little greater commentary around those efforts and maybe potential timing that we could that we might end up seeing that. Thank you.

Vivek Gupta
Sure, Marc. So actually, controlling the SG&A is really back to the basics. And looking at every line item in the SG&A to see if we can eliminate or defer spend, and the obvious target is the discretionary spend in this. So we've looked at that and we've been doing this every quarter. In fact, this is probably the third quarter in a row that we've been looking at that and seeing how we can sharpen it. And we have done a pretty decent job there. We've deferred merit

increases, we have frozen almost all hiring barring the exceptional one, which is needed from time to time.

We have actually eliminated a lot of our nonperformers or low performers, controlled travel, renegotiated contracts with some of our suppliers, eliminated internal company events. And then bonus and commission accruals have also come down. So it’s a lot of that and diligently looking at every element on a continuous basis, and, we’ve come to this point as a result of that focus.

Marc Riddick
Okay, thanks. And I was wondering if you could share if you had any thoughts on any particular, call-outs among your customer base, whether there's any particular industry verticals that are maybe showing better signs of improvement than others? Or, you know, are there any particular things that we should be thinking about as far as like any differentiated behavior among customer bases? Thank you.

Vivek Gupta
So Yes, That’s a very good question, Marc. And we are constantly looking at all the industry verticals to see if we are picking up any signs in any one of them. And, obviously, that would be the focus to see how we can capitalize on that. But unfortunately, right now, almost all industry verticals seem to be evenly balanced. Financial Services, of course, was much more impacted than the others. And as a result of that, I guess our concentration of revenues from that industry vertical has shrunk a little bit, which is good and bad, which is, of course, bad due to its--anything whenever it shrinks its bad news. But it's good because it's reducing that concentration as well. So, that's where we are. But if you're looking for positive signs, the only thing I can tell you is that after 15 months of virtually losing head count, billable head count month after month, we've had a decent October. And for the first month, we've had actually no net loss. We've actually not lost any billable consultant, and we've had a marginal increase.

Now we all know that one month does not make a trend, but we are hanging on to this positive, news. We can see a slight uptick in demand. And, let's see how the rest of the quarter turns out, but that’s a positive thing that we have seen.

Jack Cronin
Yes, and

Marc Riddick
--Thanks. sorry, guys.

Jack Cronin
Okay. Yes, another positive in Q3. In the first half of the year, a lot of our headcount decline--billable headcount, billable headcount decline happened in financial services.

I mean, we had, you know, a lot of financial services clients ending projects and delaying starts on other projects? And, you know, maybe it was because of some of the banking issues that happened in the first half of the year. But in third quarter, while we did have financial services as a net decline in headcount, it wasn't nearly as pronounced. So that was something that was positive. And one of the reasons that we made a significant improvement in third quarter with respect to our headcount loss compared to the last two quarters--or the previous two quarters.

Marc Riddick
Great, thank you.

Vivek Gupta
Thank you, Marc.

Operator
Thank you. As a reminder, ladies and gentlemen, if you would like to ask a question, please press “*”,”1” on your telephone keypad.

Our next question comes from the line of Ross Davisson with Banneton Capital. Please proceed with your question.

Ross Davisson
Hi, good morning. I had a question probably for Michael. The bookings in Q3 was down, you know, quite a bit from Q2. And even with the $3.5 million if I have that right, that was booked sort of post the quarter end. I think you're still down, sequentially. And I was hoping you could just speak to a little bit of kind of what you're seeing and why you think or, you know, anything you can say about why you're seeing a decline and kind of what gives you confidence about going forward?

Michael Fleishman
Sure. Thanks, Ross. As we’re making this transformation this year and to focusing on more data modernization services versus a very siloed MDM business, which is traditionally what we’ve been focusing on, we are building and creating pipeline almost from scratch. And in our business with a 9-month sales cycle it takes on average nine to 12 months to build up that pipeline. The weakness that we saw in our bookings was for two primary reasons.

One, as I mentioned before, due to some increased economic constraints that customers have applied to their approval processes internally on contract signatures on deals that are in excess of 500K, we had several deals slip, not all of which closed in October.

The other reason is, to be perfectly blunt with you, is we didn't have enough pipeline because we're still building that pipeline from a data modernization perspective, which is why when the deal slipped out, we had weakness or you saw weakness in our Q3 bookings performance.

The good news is, as I mentioned before, approximately $3.5 million have already closed in October. That does not represent all of the deals that slipped into Q4 from Q3. And we continue to see growth in our pipeline around data modernization services, as I also mentioned in my prepared remarks. Does that answer your question?

Ross Davisson
Yes, it's super helpful. And then I guess, you know, with respect to MDM, is that business declining in the sense that I mean, I understand you're broadening your focus, which makes a lot of sense. And then with the existing business that you had is it falling off at any at a more precipitous rate? And, I guess, is that just mostly, in your view, just the reality of the economic situation? Or do you think that there is another day that might care at work?

Michael Fleishman
Yeah. So no, I don't feel that it's falling off at a precipitous rate, at all. As a matter of fact, I don't really feel that it's falling off. The problem with only focusing on MDM and one of the major reasons why we're transforming into a much broader data modernization services company is because your cap at MDM, if you look at the total digital transformation space and the total digital transformation spend that's forecasted now through 2026, which far exceeds $3 trillion by the way - by 2026.

When you look at that, the percentage of it that is MDM, it's a very, very, very small sliver of spend versus a much larger sliver of spend around digital transformation, which is app mod and data modernization. And so, it's not that MDM is falling off or declining or even decreasing in any way, shape or form. Tt's more that we're basically saturated in the MDM market for our existing customer base.

The other thing that we are doing that I didn't mention in the prepared remarks is we're expanding our partnership base, within the MDM space. Traditionally, we've been incredibly strong with IBM. We continue to remain very good IBM partners, but we're also broadening out into other partnerships within MDM, a strong partnership with Informatica.

We just made platinum status this year, as well as Reltio and a few others, in addition to broadening out our capabilities across data modernization. So, not only are we focusing on doing more in data monetization, we're not giving up on MDM either. We are continuing to focus on growing that area, too.

Ross Davisson
Got it. Okay. Thanks, Michael, I appreciate it.

Michael Fleishman
No worries.

Operator
There are no further questions, at this time. I'd like to turn the floor back over to Mr. Gupta for closing comments.

Vivek Gupta
Thank you, Operator. So if there are no further questions, I would like to thank you for joining our call today, and we look forward to sharing our fourth quarter 2023 results with you in early February. Thank you.

Operator
This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.