

Mastech Digital, Inc. Q4 2016 Earnings Call

February-08-2017

Confirmation #13654807

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Operator: Greetings and welcome to the Mastech Digital's Fourth Quarter 2016 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.

I would now like to turn the conference over to your host Jennifer Lacey, Manager of Legal Affairs. Thank you, Ms. Lacey. You may now begin.

Ms. Jennifer Lacey: Thank you, operator, and welcome to Mastech Digital's fourth 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 fourth quarter and full-year 2016 results.

Mr. Jack Cronin: Thanks, Jenna, and good morning, everyone. Revenues for the fourth quarter of 2016 totaled \$32.4 million and were essentially flat when compared to \$32.5 million in the fourth quarter of 2015. Activity levels were solid and in line with the previous quarter.

Historically, we experienced high assignment ends in the fourth quarter, which generally results in a material contraction in our billable consultant base. In Q4 2016, we had a contraction of just three consultants, which is a significant improvement over the 47 consultant decline experienced in the fourth quarter of 2015. This performance should bode well next quarter, first quarter of 2017.

Gross profit for the fourth quarter of 2016 totaled \$6.4 million compared to \$6.7 million in the same period last year. Our gross margins for the fourth quarter of 2016 were 19.7 percent of revenues and represented a 90 basis point decrease compared to the corresponding period of 2015. The year-over-year gross margin decline was largely due to two factors - one, significantly higher client furloughs in the 2016 period compared to 2015, and these are situations where we pay our consultants their wage for hours not billable to the clients, and the second reason was higher benefit cost in 2016 compared to 2015, and this was due to less favorable medical claim experience associated with our self insured healthcare program in 2016, and it's not that our 2016 healthcare experience was bad. It was that fourth quarter of 2015 was just very, very good.

SG&A expenses were \$5.3 million in the fourth quarter of 2016 and represented 16.3 percent of total revenues compared to \$4.5 million or 13.8 percent of revenues in the fourth quarter of

2015. It should be noted that SG&A expenses in the 2015 period included \$400,000 of one-time favorable adjustments related to variable and stock-based compensation expense. Additionally, we have continued to invest in our sales and recruitment capabilities during the second half of 2016, which we believe will accelerate growth in the current year.

GAAP net income for the fourth quarter of 2016 was \$640,000 or 14 cents per diluted share compared to \$1.3 million or 29 cents per diluted share in the fourth quarter of 2015. Non-GAAP net income for the fourth quarter of 2016 was \$841,000 or 19 cents per diluted share compared to \$1.4 million or 31 cents per diluted share in the corresponding quarter of 2015.

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

Addressing our full year results, 2016 revenues totaled \$132 million and represented a 7 percent increase over 2015 revenues of \$123.5 million. This increase is reflective of our June 15, 2015 acquisition of Hudson IT.

Gross profits in 2016 were \$26.3 million compared to \$23.8 million in 2015. Gross margins as a percentage of revenues were 19.9 percent in 2016 and 19.3 percent in 2015. This 60 basis point improvement related to a favorable mix of retail channel revenues versus wholesale channel revenues, which positively impacted gross margins by 35 basis points, and higher margins on new assignments, which improved overall margins by another 25 basis points.

GAAP net income for 2016 totaled \$2.5 million or 56 cents per diluted share compared to \$2.8 million or 62 cents per diluted share in 2015. Non-GAAP net income for 2016 totaled \$3.8 million or 84 cents per diluted share compared to \$3.8 million or 85 cents per diluted share in 2015.

Full year SG&A expense items not included in Non-GAAP financial measures, again net of tax benefits, were amortization of acquired intangible assets, stock-based compensation, severance costs and acquisition transaction costs in the 2015 period. Again, a detailed reconciliation of our non-GAAP financial measures compared to their comparable GAAP measures is included in our earnings release and available on our website at mastechdigital.com.

Briefly addressing our financial position, at December 31, 2016, we had \$9.1 million of outstanding bank debt net of cash balances on hand, and our borrowing availability approximated \$12 million under our existing revolving credit line. During the year 2016, our bank debt declined by \$2.6 million.

Our accounts receivable balance at year-end 2016 remains of high quality with bad debt expense over the last three years largely non-existent. Additionally, our day sales outstanding measurement was a healthy 58 days at year-end 2016.

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

Mr. Vivek Gupta: Thank you, Jack.

Good morning, everyone. Let me supplement that narrative with comments about some of our most noteworthy accomplishments in 2016. After that, I would like to share with you my perspective on where I see Mastech Digital headed in 2017.

Our full year 2016 results validate a number of important improvements that we were able to make to the business during the year. First and foremost, COB growth, we grew our

consultants on billing or COB by approximately 4 percent during the year. While I'm not overly delighted with the 4 percent growth, this does represent the first year of growing our consultant base since 2013.

Action steps implemented during the year that influenced this return to growth included, A), the restructuring of our offshore recruitment organization, including the closure of an underperforming satellite center in Bangalore, India, B), investing in strengthening our management team, training programs and recruitment processes, which better aligns with our focus on digital technologies, and C), upgrading our sales force to resources who have experience in selling advanced technologies and IT services beyond pure staffing.

Second after COB growth was margin and bill rate expansion. During 2016, we were able to materially expand our gross margin percentage and increase our average bill rates. In fact, both of these measurements are at their highest levels since 2008, and are attributable to, A), a shift in our revenue mix to more retail clients versus wholesale clients, and B), a more disciplined posture with respect to the pricing of our services, and C), our focus on digital technologies.

And thirdly, investments for the future - during the year, we continued to invest in our business, which muted some of the positive impact of the improvements to our bottom line

results, but which were necessary for us to accelerate growth and expand our service offerings beyond staffing in 2017. In addition to strengthening our offshore recruitment organization, we have also invested in sales, marketing, human resources and practice management. I'm confident that we will see a positive return from these investments in 2017 and beyond.

Next, let me briefly give you my perception on the business as we enter 2017. I can unequivocally say that the business is in a better position to achieve sustainable growth today than it was a year ago. Our sales and recruitment associates are of higher caliber. Our management teams, both onshore and offshore, are more robust in breadth and capabilities, and we have taken steps to get closer to our major clients and to better connect with our consultant base.

Today, our organization is firmly aligned with the vision of transforming Mastech Digital from a pure IT staffing organization to a digital transformation staffing and services company. Our rebranding efforts and the establishment of several small practice areas in 2016 will likely be expanded and enhanced further in 2017. We spent time in 2016 understanding the intricacies of digital transformation needs of our customers and the areas that are best suited to complement our core competencies. I'm confident you will see additional action steps taken this year to further this strategy.

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, 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. Once again, that's star, one if you would like to ask a question. Once again, ladies and gentlemen, please press star, one now if you would like to ask a question. And as a reminder, if you are using a speaker phone, you may need to pick up the handset prior to pressing the star keys. Okay. At this point, I'd like to turn the conference back over to management for closing remarks.

Mr. Vivek Gupta: Okay, thank you. If there are no questions, I would like to thank you for joining our call today, and we look forward to sharing our first quarter 2017 results with you in late April. Thank you.

Operator: Thank you. Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time, and thank you for your participation.