MASTECH HOLDINGS, INC.
SECOND QUARTER 2014 EARNINGS CALL TRANSCRIPT

Operator: Greetings.

And welcome to the Mastech Holdings' Second Quarter 2014 Earnings Conference 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-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 Holdings. Thank you, you may begin.

Ms. Jennifer Ford Lacey: Thank you, operator.

And welcome to Mastech's second quarter 2014 conference call. If you have not yet received a copy of our earnings announcement, it can be obtained from our website at www.mastech.com. With me on the call today are Kevin Horner, Mastech'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 believe, anticipate, plan, expect, and other 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 2013 annual report on Form 10-K, filed with the Securities and Exchange Commission and available on their website at www.sec.gov.

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 second quarter 2014 results.

Mr. Jack Cronin: Thanks Jenny.

Good morning everyone. Revenues for the second quarter of 2014 totaled 27.7 million dollars or approximately 6 percent higher than second quarter 2013 revenues. While activity levels were in line with last quarter, our new assignment hit rate was below first quarter 2014's performance. Additionally, we had an unscheduled project termination on a significant integrator assignment that impacted our revenues and global consultant base during the quarter.

For the first six months of 2014, our revenue growth on a year-over-year basis approximated 12 percent which is in line with our previously stated objective of growing revenues at one and a half times our industry growth rate. However, as most of you know, that consultant based decline in Q2 will certainly have some impact on next quarter's revenue performance.

Gross profits for second quarter of 2014 totaled 5.1 million dollars or 18.5 percent of revenues compared to 5 million dollars or 19 percent of revenues during the same period last year. Our gross profit expansion reflected an increase in global consultants on assignment in the second quarter of 2014 compared to the corresponding 2013 period, partially offset by a slightly lower average bill rate in the 2014 quarter.

Our gross margin percentage was 50 basis points lower than last year's performance, as our business mix continues to shift towards our lower margin wholesale channel. Additionally, we had an increase in consultant compensation on existing projects during the quarter that outpaced bill rate increases.

SG&A expenses were 3.7 million dollars in the second quarter of 2014 compared to 3.8 million dollars in the second quarter a year earlier. SG&A expenses represented 13.3 percent of total revenues in the second quarter of 2014 compared to 14.4 percent of revenues in the corresponding quarter of 2013.

Net income from continuing operations for the second quarter of 2014 was 893,000 dollars or 20 cents per diluted share compared to 765,000 dollars or 18 cents per diluted share in the second quarter of 2013.

Addressing our financial position at June 30, 2014, we had no outstanding debt, cash balances on hand at 1.2 million dollars, and approximately 16 million dollars of borrowing capacity under our existing credit facility.

During the quarter our day sales outstanding measurement improved by six days from last quarter and now stands at 50 days which is back in line with our historical averages.

And lastly, in early July we expanded and extended for another three years our credit facility with PNC Bank. This new facility will continue to provide us with the financial flexibility to capitalize on future market opportunities. I will now turn the call over to Kevin for his comments.

Mr. Kevin Horner: Thank you Jack, and good morning.

Our second quarter performance did not meet my expectations both operationally and financially and was disappointing when compared to our historical performance trend lines. There were four primary areas of concern for me during the quarter.

Number one, our hit rate of assignment win-to-activity levels, this metrics fell for the first time in well over a year. Part of our issue here was that we dedicated considerable recruitment resources to several large project opportunities that we didn't end up winning.

The decision to execute this strategy took recruiting horsepower away from the balance of our organization, and frankly our new assignment performance suffered as a result. This resource allocation dilemma illustrates a pressing need to accelerate the scale of our recruitment organization, which we're aggressively addressing right now.

Number two, early project terminations, we have substantial integrator project that terminated about eight months earlier than previously expected. This resulted in the loss of 30 consultants on billing during the quarter, accounting for our entire consultant net growth decline.

Well, this is a frustrating event for us. Unfortunately it's an inherent risk in our industry and there isn't really a silver bullet to ensure that surprises like these do not happen from time to time.

Number three, a longer ramp time related to our new business development efforts. I have been underwhelmed by our performance to date with respect to new business development.

Last quarter, I mentioned the tangible results from those initiatives for taking longer than I had hoped. In late second quarter, we had to make some personnel changes to address the situation. My expectation is that we will see improvement in the second half of the year with respect to new business development.

Number four, gross margins, as we have stated several times in the past our expectations for gross margin are flat to a minor decline on a year-over-year basis as we continue to shift our business mix towards the wholesale sales channel.

In the second quarter, in addition to this expected business mix shift, we experienced consultant compensation increases that outpaced bill rate increases on existing projects. This is an unacceptable outcome, which we will address going forward.

While it's always challenging to get bill rate increases on existing assignments, organizationally we will link our pay side decisions to the client side decisions on bill rate increases. This whole area is something we will focus on during the balance of 2014.

I would like to highlight several positive items from the quarter as well though. Number one, IT job growth in the United States continues to outpace the growth of all jobs in the economy by a roughly three to one rate. Talent continues to tighten as well but the marketplace for IT people and IT jobs in the states continues to hit new highs every month.

Number two, July seems to have recovered nicely in terms of assignment wins to-activity levels, but as you know consistency is the key to success in this industry. I look forward to providing you with a progress report on October on this space.

Number three, in Q2 the net growth of our recruiting organization was a total of 14 people. As we have communicated before, it generally takes 60 to 90 days of training and ramp up time before we begin to see results from new hires in our recruiting model.

We are looking to begin reaping the benefits of the Q2 hiring and training that we have done in the third quarter. Additionally, we will continue to hire and scale our recruiting team.

At this time I would like to open it up 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, if you would like to ask a question, press star-one on your telephone keypad at this time. One moment while we poll for questions.

Thank you. Our first question comes from the line of Michael Conti with Sidoti. Please proceed with your question.

Mr. Michael Conti: Hi, guys. Good morning.

Mr. Jack Cronin: Morning, Michael.

Mr. Michael Conti: I just had a quick question on the gross - with the loss of project. Can you elaborate what went wrong on the project termination and how much revenue was lost?

Mr. Jack Cronin: **I** wouldn't say anything went wrong. One of our integrator clients and their end client had to agree to just to terminate project much earlier than was originally planned in terms of the duration of those 30 plus consultants that were on project.

Mr. Michael Conti: Okay.

And then with the 30 consultants, did it have an impact on gross margin with the increase in bench costs?

Mr. Kevin Horner: Not a whole lot, just a bit but it did have an impact on revenue obviously and for the full year if the project would have terminated as we originally expected the delta on revenue was in the course of the year at 3.5 million or there about. So, it hurt.

Mr. Michael Conti: Oh. Sure. Sure. Absolutely.

I guess can you, I mean who are your top 10 percent of revenue generators for the quarter?

Mr. Kevin Horner: Top 10 percent, Jack?

Mr. Jack Cronin: As far as clients, you mean?

Mr. Kevin Horner: Clients.

Mr. Jack Cronin: Yes.

In Q2, we had two clients that represented over 10 percent. Accenture, they were already at 11 percent and CGI was just over 10 percent, 10.1 percent.

Mr. Michael Conti: Okay.

Because it sounds CGI, I mean that would be considered a new client of over 10 percent.

Mr. Jack Cronin: Yes.

They actually busted through the 10 percent barrier. They have been a client with us for quite some time but first time over 10 percent.

Mr. Michael Conti: Okay.

Can you elaborate whether or not that's--did you see a significant ramp over the course of the past nine months, or is that more or else like a sustainable--I guess is that more sustainable stream of revenue going forward because last quarter you had KPMG and that seems to have fallen off?

Mr. Jack Cronin: We've been building that CGI relationship and that business frankly speaking since Q2 of 2012.

Mr. Kevin Horner: Yes.

They've been probably the last four quarters, they have been in the 7 to 9 percent range.

Mr. Jack Cronin: And been one of our best growth clients over the last three to four quarters.

Mr. Kevin Horner: Yes.

Mr. Michael Conti: Okay.

Llastly, can you just give us an update on your internal initiative to train fresh grads within the sales force space. I think, we spoke briefly about that before.

Mr. Kevin Horner: Yes.

We actually put that initiative on hold until the third quarter given the second quarter revenue issues we had and focused all of the organization on recovering the lost project revenue and at the same time holding of SG&A expense.

Mr. Michael Conti: Okay. Great. That's all I have.

Operator: As a reminder, if you would like to ask a question, press star-one on your telephone keypad. If you are using a speaker phone, you may need to pick up your handset before you press the star keys.

One moment please while we re-poll for any additional questions. Thank you. Our next question comes from the line of Dave Polonitza with AB Value Management. Please proceed with your question.

Mr. Dave Polonitza: Hey, guys. Good morning.

Mr. Kevin Horner: Morning, Dave.

Mr. Dave Polonitza: **C**an you elaborate a little more on the demand side of your business? You had the one project termination but you said you know July is recovering nicely. Just trying to figure out you know how to balance it you know between the supply and demand where--you're obviously try to work on your recruiting you know on the supply side, but has the demand worked?

Mr. Kevin Horner: Yes. Thanks, Dave.

That's a really good question. Hopefully, we try to address it subtly. But let me do it really directly. The demand side of our business still looks really solid. In fact, so far through Q3, we are probably hitting the demand side activity levels which are frankly at high points for the year. Demand is still very, very solid. Demand through the second quarter was solid. As Jack said and I tried to explain a little further, we actually went after a couple of large scale projects with a couple of our integrator clients that--where we just didn't win those.

We spent the bunch of recruiting efforts that we didn't direct at our kind of standard day in and day out demand. Part of our rationale right now and part of that focus on ramping up the recruiting organization and the fact that you know we grew the recruiting organization on a net basis by 14 people in the quarter in Q2 is to be able to position ourselves to do both, to continue to work our existing demand that's really solid and to be able to actually take on larger scale project work and not impact the standard day in and day out business.

Mr. Dave Polonitza: Just one or two follow-ups, you added a net 14 people recruiting wise. What's the ballpark number, how many people do you have right now?

Mr. Kevin Horner: It's a very low three digit number.

Mr. Dave Polonitza: Okay.

Mr. Kevin Horner: Okay?

We are now over 100 recruiters.

Mr. Dave Polonitza: Okay.

Any updates on your acquisition initiatives or is that just continuing forward as it was before?

Mr. Kevin Horner: I'll let Jack weigh in as well. We actually had a fairly active quarter, with our buy side advisory group in examining several businesses.

We haven't brought anything to our board yet from a proposal perspective but there is several things that we've--several pieces of business that we've spoken with in the quarter that we really like. Jack, would you add anything to that?

Mr. Jack Cronin: No.

We're window shopping right now. But we do like some of the things that we see.

Mr. Kevin Horner: Yes.

Mr. Dave Polonitza: Just one other final thing for Jack. Do you have the wholesale revenue number for the quarter?

Mr. Jack Cronin: The wholesale revenue number? Yes. Sure. I do have that. Give me a second. 21.6 million, retail was 6 million and we had close to 100,000 in bond [unintelligible].

Mr. Dave Polonitza: All right. Thanks, guys.

Mr. Jack Cronin: Sure.

Mr. Kevin Horner: Sure.

Operator: Our next question comes from the line of Tom Wynn with Centurion. Please proceed with your question.

Mr. Tom Wynn: Hi.

The large project that you didn't win, why did you lose?

Mr. Kevin Horner: Tom, we're actually working with our clients on both of those efforts to better understand why we didn't win. I think at this point the early indication would be a combination of price and skills.

Mr. Tom Wynn: Okay. All right. Thanks.

Operator: As a final reminder, if you would like to ask a question, press star-one on your telephone keypad at this time. One moment while we re-poll for any additional questions. Thank you. Our next question is a follow-up question from Michael Conti with Sidoti. Please proceed with your question.

Mr. Michael Conti: Yes.

Just a quick follow-up, can you talk about any pricing pressure you may have faced in the quarter and your outlook on the competitive landscape for the second half of the year?

Mr. Kevin Horner: Yes.

The market's a bit funny right now, Michael. A couple of our very large clients are pushing hard on price and that's both direct clients and integrator clients.

In the same breath, we're finding pressure in the market on the wage side given the tightness of talent. I think it's a function of the entire economy that you know the economy is growing still in fits and starts.

The IT portion of the economy is growing at a much more rapid rate than the rest of the business and a couple of our clients were actually under some pressure in the quarter and pushed fairly hard on us.

At the same time as we talked, we had some wage pressure from the longer standing consultants who actually needed - who--and it was fair that they needed wage increases.

So, we think we did as a good job as we could in balancing those things. But in some respects, I think the client base is beginning to recognize that the talent is getting tighter. We may be forced to actually market to talent to other places if we can't get the talent priced appropriately in the existing customers.

Mr. Michael Conti: Okay. That's great color. Thanks.

Operator: Mr. Horner, it appears we have no further questions at this time. I would now like to turn the floor back over to you for additional or closing comments.

Mr. Kevin Horner: No further comments on my end. I'd like to thank everybody for attending the call today. We do look forward to sharing our third quarter 2014 results with you in late October. Thanks very much all.

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