

Mastech Digital Inc. Q2 Earnings Call

July 25, 2018

Confirmation #13681757

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**MASTECH DIGITAL INC.**  
**Q2-2018 Earnings Conference Call**  
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Operator: Greetings and welcome to the Mastech Digital Second Quarter Earnings 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 introduce your host, Jennifer Ford-Lacey, Manager of Legal Affairs for Mastech Digital. Thank you, Ms Ford Lacey. You may begin.

Jennifer Ford Lacey: Thank you, Operator, and welcome to Mastech Digital's Second Quarter 2018 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](http://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 2017 Annual Report on Form 10-K filed with the Securities and Exchange Commission, and available on its website at [www.sec.gov](http://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 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](http://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 second quarter 2018 results.

Jack Cronin: Thanks, Jen, and good morning everyone. Revenues for the second quarter of 2018 totaled \$44.9 million and represented a 28% increase compared to \$35.1 million in the second quarter of 2017. Our Data and Analytics Services segment, which was acquired on July 13th, 2017, contributed \$6.1 million of revenue during the second quarter of 2018, which was below last quarter's revenue performance due to the completion of several material projects.

The good news is that the activity levels in this business segment remain very strong and we continue to win new assignments.

However, like most project-based businesses, there is some inherent risk, or some inherent lumpiness I should say, in quarterly revenues due to the timing of project ends and project starts.

Our IT Staffing Services segment had year-over-year organic revenue growth of 11% in the second quarter of 2018, as our Global Consultant base increased by 110 consultants over the last 12-month period. Demand for our IT Staffing Services remained robust during the quarter, and we were able to expand our Global Consultant base by over 6% during the three months ended June 30th, 2018. Accordingly, revenues on a sequential basis increased by close to 6% from the previous quarter as digital staffing assignments continue to drive growth at this business segment.

Gross profits for the second quarter of 2018 totaled \$10.9 million and represented a 54% increase compared to \$7.1 million in the same period last year.

Our gross margin percentage for second quarter of 2018 was 24.3% of revenues, up from 20.2% in the second quarter of 2017, and also up from last quarter's 23.7%, number.

Our Data and Analytics Services segment had gross margins of 42.2% of revenues, which were down from the 44.3% reported in first quarter of 2018. This decline reflected a cost overrun on a fixed price project in our Big Data practice area, which impacted overall gross margin percentage by 260 basis points. This project has now been completed and we're encouraged about future opportunities with this client.

Our IT Staffing Services segment had Q2 gross margins of 21.4% compared to 20.2% in the 2017 second quarter. The 120 basis point improvement from the corresponding quarter last year reflected higher direct hire revenues and higher margins on new assignments, largely those deploying advanced, advanced technology skill sets.

SG&A expenses were \$6.4 million in the second quarter of 2018 and included several one-time items that on a net basis reduced SG&A expense by \$1.5 million. So, let me give you a little color on what made up the net credit of \$1.5 million in SG&A expense in Q2 2018.

First, we revalued a contingent consideration liability that was booked at the closing of our InfoTrellis acquisition, and pertained to our estimate of the two-year contingent earnout payments, and this revaluation resulted in a \$9.1 million reduction to this liability. We also had another \$100,000 adjustment in estimated investment banker fees associated with the contingent consideration. So, in layman's terms, the one-year earnout will not be achieved, and this is the primary driver behind the revaluation. Both of these items, the reduction in liability as well as the adjustment in transaction cost, are reflected as reductions in SG&A expense in our Condensed Consolidated Statement of Operations for Q2 2018.

As a result of the revaluation, we performed a quantitative impairment test on our Data and Analytics business as of June 30th, 2018, and this testing indicated a \$7.7 million impairment associated with the carrying value of goodwill. Accordingly, this goodwill impairment charge is also reflected as an additional expense in SG&A in the second quarter of 2018. Again, the net of these three items is a \$1.5 million reduction to SG&A expenses in the second quarter of 2018.

Exclusive of these three items that I just mentioned, as well as the amortization of acquired intangible assets, our adjusted SG&A expense as a percent of revenue was 16% in Q2 of 2018 compared to 16.5% in the previous quarter ie. first quarter of 2018, and the takeaway here is

that our adjusted SG&A expenses as a percent of revenue declined in Q2 2018 from the previous quarter.

GAAP net income for the second quarter of 2018 was \$2.8 million or \$0.51 per diluted share, compared to \$696,000 or \$0.15 per diluted share in the second quarter of 2017.

Non-GAAP net income for Q2 2018 was \$2.3 million or \$0.41 per diluted share, compared to \$1.1 million or \$0.23 per diluted share in the corresponding quarter of 2017.

SG&A expense items not included in non-GAAP financial measures net of tax were amortization of acquired intangible assets; stock-based compensation; acquisition transaction expenses/credits; goodwill impairment; and the revaluation of the contingent consideration liability, and are all detailed in our second quarter earnings release which is available on our website.

Briefly addressing our financial position, at June 30th, 2018, we had approximately \$37 million of outstanding bank debt, net of cash balances on-hand, and our borrowing availability was \$12 million under our existing revolving credit line. Further, we believe that our accounts receivable balance is of very high quality, however, our days sales outstanding measurement is a bit

elevated due to some distractions associated with the implementation of our new cloud-based ERP system. We would expect our DSO measurement return to more historical levels by the end of Q3 2018.

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

Vivek Gupta: Good morning everyone. Thank you, Jack, for the detailed financial review of our second quarter 2018, clearly another exciting quarter for Mastech Digital.

First, I must tell you that I enjoy these calls so much more when I can say we delivered a quarter of record earnings. Well, this quarter, I'm delighted that I can make that statement once again after saying it for the first time in our first quarter 2018 earnings call. This quarter was our second consecutive quarter of record, record earnings. An outstanding performance for our entire organization, and a sincere thank you to all of our highly committed and dedicated associates.

I'm also happy to highlight the Board's decision to declare a 2-for-1 stock split of our common stock. Clearly, this action reflects the Board's confidence in our strategy, our people and our



future opportunities. On behalf of my Management team, I would like to thank them for the trust in our collective abilities.

Recently, I also want to point out what we believe is another advantage of the stock split, which is that it will increase the liquidity of our shares for both shareholders and potential investors.

Having made these important acknowledgments, let me share with you my thoughts on the performance of our two business segments during the second quarter of 2018.

Data and Analytics Services. We continue to see strong pipeline demand for our D&A services, and we secured a number of projects with some exciting new logos during the second quarter. However, we did have a few material projects reach completion, which pulled our revenues below the revenues we reported last quarter. As I've stated in our previous calls, our Data and Analytics Services business has inherent lumpiness due to it being mainly project-based, and therefore, some fluctuation is expected in the revenues from quarter to quarter.

I continue to be extremely confident in all aspects of this business. So much so that in April 2018 we upgraded and expanded our Global Delivery Center in Chennai, India, which will give us the ability to nearly double our manning capacity there from existing levels.

Additionally, we will continue to look to expand and upgrade our Sales organization, an initiative that started in earnest in Q4 of 2017.

Turning to our IT Staffing Services segment, we are firing on all cylinders in this business. As Jack mentioned, organic revenues grew 11% in Q2 on a year-over-year basis. We are adding nicely to our billable consultant base. Gross margins have improved by 120 basis points from Q2 of 2017, and our operating cost structure has stabilized from investments made in 2017. Simply put, we are dropping more revenue dollars to the operating income line.

Additionally, we continue to secure more assignments with advanced technology skill sets, a transition that started more than a year ago.

Organizationally, we continue to tweak certain areas of our business for incremental improvements while promoting creative thinking about how we conduct our business. I say with confidence that morale is very high throughout the entire organization.

In summary, I feel good about the quarter that we delivered. I feel happy about the Board's action with respect to the stock split, and I am very excited about the prospects and future that lie ahead for Mastech Digital.

I will now open this session for your questions.

Operator: At this time, we will 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, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue.

As a final reminder, if you would like to ask a question, please press star, one on your telephone keypad.

I would like to turn the call back to Vivek Gupta for closing remarks.

Vivek Gupta: Thank you, Operator. If there are no questions, I would like to thank you for joining our call today, and we look forward to sharing our third quarter 2018 results with you in late October.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.