Mastech Digital Inc.
Q4 2022 Earnings
February 8, 2023

Operator
Greetings, and welcome to the Mastech Digital Inc. fourth quarter 2022 earnings conference call. At this time, all participants are in 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 Lacey, Manager of Legal Affairs for Mastech Digital Inc. Thank you. You may begin.

Jennifer Lacey
Thank you, operator, and welcome to Mastech Digital's fourth quarter 2022 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 recently appointed Chief Executive Officer of the company's Data 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 2021 annual report on Form 10-K filed with 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 fourth quarter and full year 2022 results.

Jack Cronin
Thanks, Jen, and good morning, everyone.

Fourth quarter 2022 was clearly a difficult quarter for Mastech Digital, as we saw both of our business segments negatively impacted by economic uncertainty, including customer concerns regarding inflationary conditions and a possible recession. Revenues for the quarter totaled $57.2 million, representing a 3% revenue decline compared to $59 million in Q4 2021.

Our Data and Analytics Services segment contributed revenues of $9.1 million in Q4 2022 compared to $10.1 million in the 2021 fourth quarter as order bookings in the second half of the year came in short of expectations, and as a result, utilization rates were well below our historical norm.

Q4 2022 revenues in our IT Staffing Services segment totaled $48.1 million compared to $49 million in the fourth quarter of 2021. Customer demand declined during the quarter, which when combined with seasonal high levels of assignment ends, resulted in our lower revenues.

Consolidated gross profits in the fourth quarter of 2022 totaled $14.2 million compared to $15.7 million in the fourth quarter of 2021. Gross margins as percent of revenue in Q4 2022 was 24.8% compared to 26.6% in the 2021 fourth quarter. This margin decline was entirely related to our D&A Services segment and was attributable to lower utilization and reduced margins on several long term assignments, largely due to compensation increases in today's inflationary environment.

GAAP net income in the fourth quarter of 2022 was $1.5 million or $0.13 per diluted share compared to $3.9 million or $0.32 per diluted share in Q4 2021.

Non GAAP net income for Q4 2022 was $2.8 million or $0.23 per diluted share compared to $4 million or $0.34 per diluted share in the fourth quarter of 2021.

SG&A expense items not included in Q4 non GAAP financial measures net of tax benefits are detailed in our fourth quarter 2022 earnings release, which is available on our website.

Highlighting our full year 2022 results, revenues were $242.2 million, which were up 9% year-over-year as both of our business segments achieved revenue growth during 2022.

IT Staffing Services had 10% revenue growth in 2022 and D&A Services had 6% revenue growth.

Consolidated gross profits grew to $63.2 million in 2022, up 6% compared to $59.4 million in 2021.

GAAP diluted earnings per share were $0.72 in 2022 compared to $1.02 in 2021. And non GAAP diluted earnings per share were $1.13 in 2022 compared to $1.19 in 2021.

During 2022, our liquidity and overall financial position remained strong. Today, we are 100% debt free; we have cash availability of approximately $32 million under our revolving credit facility. Additionally, our credit facility's Accordion feature can provide us up to an additional $20 million in term loan capacity for M&A activity. And our days sales outstanding measurement at December 31, 2022 improved to 59 days from 61 days a year ago.

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 operating results for 2022.

Let me start by saying the obvious - our 2022 financial results didn't end up the way we started in the first half of the year. Concerns over a possible recession, high inflation and an acceleration of interest rates have led to many of our clients taking a conservative posture with respect to spending, which clearly impacted our demand curve in the fourth quarter 2022.

However, despite the fourth quarter's underwhelming performance, for the full year 2022, we achieved 9% revenue growth, 6% gross profit expansion and solid profitability. And I believe that our businesses and their future prospects remain fundamentally strong.

Let me point out a number of positives heading into 2023.

First, we have on board a new Chief Executive Officer for our Data and Analytics Services business, Michael Fleishman, who I will introduce to you in a few minutes.

Second, our Board of Directors has authorized a share repurchase program of up to 500,000 shares of the company's common stock over the next two years. As described in our earnings release, repurchases will be dependent upon market conditions, regulatory requirements and other considerations.

Third, our balance sheet has never been stronger. We currently have no bank debt. We have access to approximately $32 million of borrowing availability and up to an additional $20 million for M&A activity.

Fourth, we have a business model that historically generates free cash flows that should strengthen our balance sheet even further as the year progresses.

And finally, fifth, we have high quality accounts receivables with a days sales outstanding measurement of 59 days.

Let me now introduce to you Mr. Michael Fleishman, our new Chief Executive Officer of the Data and Analytics Services segment. I won't steal Michael's thunder, but I have to say that he is a very strong addition to our management team with an impressive background, and I believe Michael will be a difference maker in our ability to execute our business plan more effectively and accelerate revenue growth.

Over to you, Michael.

Michael Fleishman
Thanks – Just a few seconds on my background. I have a little over 26 years of enterprise IT experience with close to 14 of it being with IBM, where I held sales and sales leadership positions across the majority of IBM's portfolio at the time, hardware, software and services, both consulting as well as traditional IT outsourced services. I left IBM in 2010 to pursue roles as a P&L owning GM as well as sales leadership roles across several well known services providers that have strong delivery capability out of India.

Before joining Mastech, I ran Digital Transformation for capital markets in North America at Cognizant. The majority of my 26 plus years have been spent driving strong levels of sales growth across multiple verticals, both across North America as well as globally for the companies I was with.

I joined Mastech late last year because I saw a company with excellent capabilities across data modernization, especially in data management and data warehousing, warehouses, lakes and lake houses with a strong customer base of marquee logos that had not fully capitalized on their opportunity for growth nor on their competitive differentiation in data modernization.

I think it's not just a dream of mine, but a dream of many leaders to have the opportunity to work for a company that has Mastech's strengths and capabilities, not to mention existing customer base with so much upward mobility in front of them and a market space where the demand is expected to exceed $3 trillion by 2026.

Mastech's capability to deliver, our competitive differentiation and the significant opportunity for growth in front of us were the primary reasons why I joined Mastech.

I'll turn the call back to you, 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. 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. One moment please while we poll for questions.

Thank you. 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
Good morning, Lisa.

Lisa Thompson
Welcome, Michael. Sounds like you have an excellent background for this position, and it's very exciting to hear from you.

Michael Fleishman
It's excited to be heard from. Thank you.

Lisa Thompson
So I guess the number one question is, after last quarter's call with your record IT staffing revenue, it seems like everything fell apart quickly. And I know it's not your first time through business cycles. I was wondering if you could like go into a little detail of what happened?

Vivek Gupta
So, Lisa, the IT staffing got impacted because of the drop in revenue that I mentioned in the last earnings call that happened in Q3, and it continued into Q4. So we had a drop in demand, and that impacted this number of starts that we have on the staffing side. And then we also had much higher than the seasonally expected ends that we expect in Q4. Q4 is always a low quarter from an ends point of view. There are more ends in that quarter seasonally than other quarters. But this time, they were even more than usual. It's really that same kind of equation

which is not enough starts and higher number of ends, and that ended up impacting our staffing business.

The positive note that I can share is that the demand seems to be better. We've only had five weeks into this quarter, but the demand seems to be better this quarter than what we saw in Q4. We are optimistic, but it's still too early for this quarter. But I guess that's how the market is panning out.

Lisa Thompson
So is there any bright side to this? Are you having -- obviously, everybody being laid off in Silicon Valley -- is it easier to find the ideal people for your needs?

Vivek Gupta
Yes, to some extent, there is a larger pool available now because there are so many companies which have let go of large numbers of IT resources. But for us to be able to fully leverage that, we also need to have greater demand. And right now, customers are being cautious, right, in light of the recessionary conditions or seeing what's happening elsewhere in the other IT companies. So the demand needs to pick up, but definitely there is -- the pool is becoming a little larger right now to fish from.

Lisa Thompson
All right. That totally makes sense. How do you feel this is going to flow through to next year? Is it just -- you think it's going to be a down year for revenues just because of the economy?

Vivek Gupta
Lisa, no, we are not taking that attitude or approach. We are -- as I said, it's only the first few weeks. We are seeing some signs of demand picking up. But we still have to see how the year is going to pan out. But we are preparing for growth rather than preparing for any shrinkage. So we will, of course, be very careful with our costs. We'll keep a very close eye on the demand and take a quick action as we did in 2022 when COVID hit us and we got adversely impacted, and we did a pretty decent job in the first couple of quarters controlling our costs. So we'll keep a keen eye on this and see if that needs to be done. But we are actually preparing for some growth rather than shrinkage in this year.

Lisa Thompson
And I guess the last logical question is, given the economy and the opportunities, are you going to be more likely or less likely to do M&A?

Vivek Gupta
I think the honest answer, Lisa, is that Michael has just come on board, and the year is -- because there's a lot of changes that Michael is bringing into the organization, I think we just have to give ourselves a little bit of time for him and the organization to settle down. But we have not shelved the idea of the M&A. We are still going to go back to it. It may be a little later

in the year, later quarters, but it's definitely on the cards. We will get back to the strategy of inorganic acquisition.

Lisa Thompson
All right. I guess my final question has been how many consultants did you end the quarter with?

Vivek Gupta
Jack, can you have a look at that?

Jack Cronin
Yes. Consultants at the end of the quarter?

Vivek Gupta
Yes.

Jack Cronin
Sure. We had 1,208.

Lisa Thompson
Great. Thank you. That's all my questions.

Vivek Gupta
Thank you, Lisa.

Jack Cronin
Thank you.

Operator
Our next question comes from the line of Timothy Call with The Capital Management Corporation. Please proceed with your question.

Timothy Call
Good morning. Given your history of accretive acquisitions, and the last one AmberLeaf was roughly $10 million, do you consider the $52 million of potential borrowings for acquisitions to be exceedingly high? Would you ever have multiple acquisitions or acquisitions that large? And are your disciplines for acquisitions still the same where they would be immediately accretive and additive to the company?

Vivek Gupta
I think, Tim, we don't have any targets right now in front of us. But it could be one large acquisition, it could be multiple or maybe two smaller acquisitions. It would depend what kind of companies are out there and what kind of pricing they'll be able to command. But I think this

total war chest that we have, which Jack mentioned, of about $52 million plus we think is adequate for what we need. We may not even need all of it, or we may need (inaudible) a function of what kind of company we find out there.

Timothy Call
And in the interim, given your free cash flow and $7 million of balance sheet cash and zero debt, do you expect to actually repurchase some stock in the upcoming year?

Vivek Gupta
Jack, do you want to take that?

Jack Cronin
Yes, the Board approved a 500,000 share repurchase program. So, yes clearly our goal is to buy back some of our shares.

Timothy Call
Well, it's at a terrific price, so an acquisition one way or another, but you know your company well and know how good it is. So that makes sense in the interim. Thank you very much.

Vivek Gupta
Thanks, Tim.

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

Our next question comes from the line of Marc Riddick with Sidoti. Please proceed with your question.

Marc Riddick
Hey, good morning, everyone.

Vivek Gupta
Hi, Marc.

Marc Riddick
Michael, welcome aboard. Looking forward to working with you going forward.

Michael Fleishman
Thanks, Marc.

Marc Riddick
I wanted to talk a little bit about some of the basics. The way you talked about the pacing around the client demand slowdown. And then I was wondering if you could talk a little bit

about some of the things that you're seeing maybe around bill rates and pricing dynamic of what you are working with? And then also if you could sort of give a little bit of color around whether or not that demand -- are you getting the sense that that demand is a matter of just delayed activity by clients or projects that are going away for a period of time?

Vivek Gupta

Sure, Marc. There are multiple sort of mini questions embedded in your question, so let me try and address those one by one. So on the bill rate front, we've actually not seen any major, what shall we say, pressure at this point in time. In fact to the contrary -- over the last few quarters, we've been able to steadily increase our bill rate, and I'm talking more on the staffing side. And the pricing is always a function of what is the market command for that kind of offering and also what it is that we need to pay to our resources. So we've been able to maintain the gross margins there and manage our pricing accordingly. So that's how it is. In terms of demand, it's slightly different between staffing and data and analytics. And maybe I'm going to give Michael a chance to talk about the data analytics part in a minute.

But on the staffing side, there is actually a pretty close correlation between the state of the economy and the demand on -- for staffing. And the time difference between the two -- the reaction time is actually pretty small. So there’s -- just a couple of quarters ago, there was -- the worry about the recession was extremely high. It's still there, but it's to a lesser extent right now. And that's probably what's going -- what's maybe easing the drop in the demand that we saw. So we are hopeful that we will see a pickup in demand over the next few quarters. Of course, nobody has a crystal ball, but at least early indications are that's what's going to happen.

So that's all on the staffing side. And on the data analytics side, the dynamics are slightly different. So Michael, would you like to comment on that?

Michael Fleishman

Sure. So while a recession -- or rather, I should say, the fear of a potential recession is causing some customers not so much to slow down, but to be a little leery until they see the actual impacts to their bottom lines. So we are seeing some small percentage budget cuts into customers' IT budgets in 2023 over what they had in 2022. That being said, digital transformation will not be impacted by a recession for a couple of years at least at a minimum. That spend is still ongoing, and a lot of our customers have locked in a multi-year spend budget for their digital transformation initiatives, whether you're talking application modernization, legacy modernization or data modernization, all of which play into digital transformation.

What we have actually seen is, because of the issue around attrition and the ability to retain IT professionals as well as the inability to fulfill demand for IT professionals that we experienced in 2022, it's actually driving rates higher versus having to cut rates in the digital transformation space. People are having to pay more to get the same skills that they had to pay less for in previous years. And it is because the attrition is so high. The average attrition across IT services in 2022 was 25.2%, for example. That's actually one of the competitive differentiations that Mastech (inaudible) has over the market because our attrition in 2022 was 9%. I've been waiting for an opportunity to say that. So that's what we're seeing in the D&A space. I hope that answers your question. If not, I'm happy to go into more detail.

Marc Riddick
No, that's certainly helpful. Thank you. And then I was wondering if you could talk a little bit about -- and you touched on this already as far as the timing of targeting acquisitions, and that's certainly understandable given the timing of you joining the firm. I was wondering if we sort of just confirm -- I would imagine that the prioritization remains within D&A, but I was wondering if you could sort of talk about just overall prioritization of acquisitions and whether that has changed at all and/or if you have any particular views on just the general pricing environment that's out there that you think you might be able to take advantage of?

Vivek Gupta
So, Marc, I don't think there's any change in our thinking, our strategy regarding the acquisitions. We will probably fine tune it. As I said, just giving Michael a little bit of time to settle down, and then we'll fine tune our requirements and initiate the search. So right now, there is really no change to what our thinking has been. Our acquisitions will be on the data analytics side and not on the IT staffing side. That's something I've said multiple times before, and that remains unchanged.

Marc Riddick
Okay, great. And then just to confirm, so if you are finishing the year with a headcount at just over 1,200, are there any thoughts as to sort of where you would like that to be through the year or any thoughts at least in the near term as to where that can go?

Vivek Gupta
So, Marc, obviously, the plan is always to grow that number and not let it stay at this number or reduce. And that's what the entire organization is working towards. But as I said, it's difficult to give a -- first of all, we don't give any guidance, but it's also -- directionally also, it's difficult to predict how the next few quarters are going to pan out. But we are encouraged with what we have seen in the first few weeks - not a dramatic increase in demand, but better than what we saw in Q4. So that sort of directionally tells us, and we are hopeful that we will be able to grow over the year.

Marc Riddick
Okay. And then the last thing for me -- I was sort of curious as to whether or not you've seen any -- were there any differences in behavior or any stand up, either positively or negative, when it comes to client verticals. Were there any particular groups that maybe were a little more cautious than others or vice versa? Thank you.

Vivek Gupta
Yes, actually it's interesting. This time around, it's unlike the 2020 COVID times when it was focusing, I guess -- there was positive on the healthcare side and extreme negative on the entertainment and hospitality side. This time, it's -- the verticals are fairly similar in their behavior. I think everybody is being cautious and trying to control spend and not make any big investments on new initiatives. And that seems to be across the board. But clearly, two verticals do stand out where I think the caution has been a little more. One is on the IT InfoTech side, the technology side, and we hear that news every day from these big organizations. And the other one is, maybe to a lesser extent, the financial services, banking financial services. But all the other industries are just almost equally being cautious.

Marc Riddick
Okay. And then the last one for me - I'm sort of curious if you could touch a little bit as to the -- I mean, I can imagine sort of you wanting to take advantage of the opportunity, but maybe sort of talk a little bit about sort of the Board's thinking around the implementation of the share repurchase program, the authorization and maybe sort of talk us through a little bit about sort of how that came to be and maybe the timing there? Thank you.

Vivek Gupta
So Jack, would you take that? The repurchase--

Jack Cronin
--As far as the timing?

Vivek Gupta
Yes

Jack Cronin
Yes. Well, I mean, the program is in effect. We can execute it at any time. And we're going to be a little bit constrained by our daily volume because I think we can only purchase I think it's up to 25% of our daily volume. So we're going to monitor the volume and get into the market when we think it's most appropriate.

Marc Riddick
Right. But -- I'm sorry. I should have clarified. I think the press release said it was a two year period.

Jack Cronin
Yes, it’s a two year period. Right. So the last time we did a share repurchase program, we had -- I think it was a two year period, and we extended it. We can always extend it. But it's a two year period, you're correct.

Marc Riddick

Okay, great. Thank you very much.

Vivek Gupta
Thanks, Marc.

Operator
A final reminder - if you would like to ask a question, press star, one on your telephone keypad. One moment please while we repoll for any additional questions.

Mr. Gupta, it appears we have no further questions at this time. I would now turn the floor back over to you for closing comments.

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 first quarter 2023 results with you in early May. Thank you.

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.