MASTECH HOLDINGS, INC.

FIRST QUARTER 2014 EARNINGS CALL TRANSCRIPT

Operator: Greetings, and welcome to the Mastech Holdings, Inc., First Quarter 2014 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. I would now like to turn the conference over to your host Ms. Jennifer Lacey, Manager of Legal Affairs. Thank you. You may begin.

Ms. Jennifer Lacey: Thank you, operator, and welcome to Mastech's first 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 "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 that--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 review of our first quarter 2014 results.

Mr. Jack Cronin: Thanks, Jen, and good morning. I'd like to start by reminding everyone of the sale of our healthcare segment during the third quarter of 2013. Please note that our financial statements for prior periods have been recast to include our healthcare business as discontinued operations. Accordingly, all financial results discussed today relate to continuing operations, unless specifically noted otherwise. With that clarification out of the way, I'm pleased to report revenues for the first quarter of 2014 totaled $28.7 million or approximately 20 percent higher than first quarter 2013 revenues. Our IT operations continued to see solid activity levels during the quarter, despite some softness in early January. Thus, we were able to grow our consultants on billing for a fifth consecutive quarter. Growth profits for the first quarter of 2014 totaled $5.2 million or 18.2 percent of revenues compared to $4.4 million or 18.2 percent of revenues during the same period last year. Our gross profit expansion reflected an increase in billable consultants on assignment in the first quarter of 2014 compared the corresponding 2013 period as well as a slightly higher average bill rate in the 2014 period. Our gross margin percentage was flat compared to the first quarter of 2013 as higher margins in our retail channel offset lower margins in our wholesale channel, where bench costs were higher in the 2014 period. It should be noted that our gross margins are historically lower in Q1 due to higher payroll taxes and generally higher bench costs. SG&A expenses were $3.8 million in the first quarter of 2014 compared to $3.5 million in the first quarter a year earlier. SG&A expenses represented 13.4 percent of revenues in the first quarter of 2014 compared to 14.5 percent of revenues in the corresponding quarter of 2013. Net income from continuing operations for the first quarter of 2014 was $869,000 or 20 cents per diluted share compared to $544,000 or 13 cents per diluted share in the first quarter of 2013. Addressing our financial position, at March 31st, 2014, we had outstanding debt net of cash balances on hand of $1.1 million and over $15 million of borrowing capacity under our existing credit facility. During the quarter, we invested $2.6 million in operating working capital. As we mentioned in our earnings release, this investment in part was due to an increase in our days sales outstanding measurement that reflected billing process changes at a major client. Now, while this situation impacted Q1 cash flows, it's not a collection issue, and we would expect that our DSO measurement would revert back to more normal levels next quarter. I'll now turn the call over to Kevin for his comments.

Mr. Kevin Horner: Thanks, Jack. Good morning, all. I'm pleased to report another quarter of strong year-over-year top-line and bottom-line growth at Mastech. As you all know, historically, Q1's been a challenging quarter for the industry in general. Even so, we were able to grow our billing consultant base by 3 percent. For some context for

Mastech, 3 percent sequential growth in Q1 is our second best net growth performance for consultants on billing in the first quarter in the last 10 years. Financially, our operating results continue to largely speak for themselves, top-line year-over-year growth of 20 percent, far exceeding our target of 1.5X the industry growth rate, bottom-line year-over-year growth of 54 percent, further reinforcing the value of our business model, and a strong balance sheet with a sufficient access to capital. Operationally, we're focused on building out a new client acquisition engine capable of contributing to our growth objectives for 2014 and beyond. As of today, we have a total of 15 new clients in various stages of contract development and job requisitioning. Additionally, we have two dormant accounts, which we resuscitated over the last 90 days and are now working day in and day out. In addition, we continue to invest in our recruiting and delivery organization with a particular focus on continuing to hire and to develop talent in our India-based recruiting centers. Our commitment to our customers and to our organization is to continue to scale and upgrade our recruiting team to continue to provide a reliable source of IT talent for the market. Lastly, you may have noticed we've recently reported we have entered into a new long-term lease for some new space for our Pittsburgh-based headquarters. The new space is five minutes from our existing office and should provide a wonderful new working environment for our employees, customers, and investors. Current plans are to relocate in Q3 when the new space has been completed. In closing, I'd like to offer a well done to the team at Mastech and a thank you to our clients and our shareholders for their continued support. At this time, I'd like to open it up for your questions.

Operator: Thank you. 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'd 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. Thank you. Our first question is coming from the line of Howard Rosencrans with Value Advisory. Please proceed with your question.

Mr. Howard Rosencrans: Hi, guys. Congratulations. Great quarter. In terms of the major client is there any issue in terms of their business or are you switching to other people or can you give us some more color regarding this major client?

Mr. Kevin Horner: Sure. Let me give that a shot, Howard. Thanks for your question and thanks for your comments. No, it's a really solid customer. We expect to do more work with them. My sense is it's the customer that Jack spoke of is a client in our integrator group. I think they had a change with a large-scale client of theirs and we found that billing process change to be a flow down. So, it took us about a quarter to get it all worked through with the client and we believe we're on track now.

Mr. Howard Rosencrans: Okay. There's a lot in the--.

Mr. Kevin Horner: No, we like the business. We'd love to have more of it.

Mr. Howard Rosencrans: Just to change gears, there's lot in the press about the favorable temporary trends despite the uptick in jobs. Do you see in any way that changing or better or worse that people will go more to permanent hires? Do you feel like Obamacare is something ensures that people will stay in the temporary world, and I guess more specific to IT but just looking for some big macro color and on that trend?

Mr. Kevin Horner: Yes, I think it's a great question. Yes, so, now, you'll get one man's opinion, right? But, I've been saying for a while on these calls and when I talk openly anywhere that I believe that the marketplace trends that have emerged coming out of the last downturn will have businesses buying more talent on a temporary basis than they may have historically. So, I believe that trend--and that's a trend that you'll see reported all over the place--I believe that's a trend that's here to stay. Number two, the IT industry in particular has been one that has operated with a temporary set of talent for a long, long time. And you know, in my past world, I operated at a minimum of a 40 percent ratio of 60 percent internal employees, 40 percent external employees and I did it for a couple of reasons. It allowed me to quickly move. It allowed me to quickly change skills. So, I believe our industry--that the IT industry in particular will continue to operate in that fashion. I don't see change happening there either. I would like to believe your reference to the Affordable Healthcare Act would benefit temporary labor businesses like ours. Time will tell on that one, Howard, let's put it this way. We're not banking any of that into our planning process. Okay? But I personally think it almost has too because we adopt a level of risk and a level of liability in that world that others may not want to take on.

Mr. Howard Rosencrans: Great. Thank you.

Mr. Kevin Horner: Thanks for your questions.

Operator: Thank you. Our next question is coming from the line of Brian Warner with Performing Capital. Please proceed with your question.

Mr. Brian Warner: Hi, guys. I think it was you, Kevin, who mentioned in the prepared remarks that you were talking to maybe 15 or so sort of new customers. I'm wondering if you're doing anything different on business development or sort of what's happening --you've got this nice thing occurring.

Mr. Kevin Horner: Thanks. Thanks for the question, Brian. Did you think those remarks were prepared? We did those right off the top of our heads.

Mr. Brian Warner: Sure.

Mr. Kevin Horner: No, the 15 new customers that we referenced in there are part of a designed program to grow our end user customer base. Our determination back in about Q3 was- we now had a recruiting engine, a motor that was working. This centralized recruiting model that we operate, we determined that it was working with our existing client base and it was time to bring some new customers into that model. Beginning in Q3 spec--particularly in Q4, we went out, and we hired some folks on the sales side that were just able to go out and into hunt new clients. We went after a really specific set of clients that work well in our business model. We're after clients who have already adopted the more electronic way of doing business in this temporary labor situation. We went after VMS or vendor management system or MSP, managed service providers who actually use a VMS. We went after that style of client and my commentary was we have about 15 new people in various stages of development. We have a couple of new folks that we're working with directly that we're getting their job reqs that we're recruiting for and we're filling - all the way back to some people who are pretty early in that pipeline. These are larger-scale customers who don't easily add a new vendor into that vendor management system. The process takes a little bit. It's an investment on our part but it's a long-term investment.

Mr. Brian Warner: Gotcha.

Mr. Kevin Horner: Does that help answer--?

Mr. Brian Warner: A couple more--.

Mr. Kevin Horner: What you were thinking about, Brian?

Mr. Brian Warner: Absolutely. A couple more quick ones. You know, it seems like--well, let me start with you've sort of said a while ago that you were strategically within technology maybe sort of making certain bets, for lack of a better term on new areas. I mean, search-engine optimization I don't believe was one of them. Maybe it was - I can't remember, I'm kind of wondering how that's panning out. I guess the reason for the question is it seems like, in technology, particularly in Silicon Valley, it has just become very, very difficult to find people. I'm wondering if, you know, sort of the spaces that you're focused on would sort--of the dynamics there.

Mr. Kevin Horner: Yes, I think it's a really good question. So, obviously, a piece of our growth strategy is to build out, to build some depth, in a technology-based practice area or two. We have laid that strategy out. We are in the process of hiring somebody into the organization, ideally late second quarter, early third quarter to run and manage that piece of our growth platform. We have not begun the investment of building skills yet in one of those new technology platform areas. We have not ramped that up. We've recruited some existing skills out of the market and are selling those into our existing client bases. We have not begun to actually invest in skills, which basically means go out and hire some people on the com, train them up into the--into a new skill platform, and then take them into our new client base. That's an investment that we'd begin to make in the third quarter.

Mr. Brian Warner: Okay. Quick question. I know you guys, I believe retained somebody sort of to do some banking to maybe show you some acquisitions, I'm wondering, you know what the markets like for stuff like that and if you guys are seeing anything interesting.

Mr. Kevin Horner: Yes, what you're talking to is the kind of the fourth piece of our growth strategy, which is really all about - we have been focused for the past two years on growing our business organically, right, on developing out this recruiting engine and developing out the talent side of our business so that, you know, we could do much better as a talent partner for our existing customers. We've determined in Q1 that our approach to acquisitive growth is going to have to be different in 2014 than it has been in 2012 or 2013. Our approach in 2012, 2013 was much more of, I'll call it an ad hoc, approach where stuff came across our desks, and we took a look at it, something we liked -we'd call and it in. In Q1, we've actually hired an investment banking company to help represent us on the buy side and I think the marketplace out there is actually very interesting right now. The potential universe of the kinds of--the styles of companies that we would look to acquire in the U.S., is a three-digit number.

Mr. Brian Warner: Wow.

Mr. Kevin Horner: Yes, we have now moved from an ad hoc process to a--, a multiyear, multitransaction systematic way of thinking about how to acquire.

Mr. Brian Warner: Gotcha. Sounds good.

Mr. Kevin Horner: Time will.

Mr. Brian Warner: Thanks.

Mr. Kevin Horner: Yes, Brian, time will tell. We'll--you know, time will tell. But, that's what we've done.

Mr. Brian Warner: Terrific. Thanks a lot.

Operator: Thank you. The next question is coming from the line of Michael Conti with Sidoti. Please proceed with your question.

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

Mr. Kevin Horner: Hi, Mike.

Mr. Michael Conti: With the 15 new clients, how many of those do you have, consultants on those projects and if you guys are actually seeing a revenue stream from those clients?

Mr. Kevin Horner: Yes, one.

Mr. Michael Conti: Just one?

Mr. Kevin Horner: One.

Mr. Michael Conti: Okay.

Mr. Kevin Horner: Yes, and the revenue stream it's not worth discussing yet.

Mr. Michael Conti: So, we should see some type of, I guess, bump in revenues going through the second half of the year once you get more consultants on those particular projects.

Mr. Kevin Horner: Yes, we would certainly hope so. Yes in fact, we've had much more success with the two customers that were dormant that hadn't been worked in several years in resuscitating those back to life. We've had a much better--much, much higher success rate with those than we have with our brand new clients.

Mr. Michael Conti: Sure and I guess can you just throw some color, I guess, on the sequential growth rate going from fourth quarter 2013 to first quarter '14? Seems a bit low compared to last-year numbers as well and take into consideration the increase in consultants on billing growth from the third quarter to the fourth quarter. Any color on that would be great.

Mr. Kevin Horner: Q4 '13--I'm assuming you're talking Q4 '13.

Mr. Michael Conti: Into this year, Yes.

Mr. Kevin Horner: Revenue.

Mr. Michael Conti: Yes, top line; First quarter '14 was 20 percent, so, down a little bit year-over-year, but not down much.

Mr. Kevin Horner: Yes.

Mr. Michael Conti: No, what I'm getting at is a sequential growth because you guys added, let's see here, about 10 consultants in the fourth quarter, which it was the second time you guys had positive growth.

Mr. Kevin Horner: Yes.

Mr. Michael Conti: In the history of--.

Mr. Kevin Horner: Yes.

Mr. Michael Conti: Mastech - but on a sequential basis, going from the fourth quarter 2013 to the first quarter of '14, grew about 70 basis points. Wondering--I kind of had modeled a bit higher growth rate, given the increase in, COB growth. Were there any?

Mr. Jack Cronin: Sequentially.

Mr. Kevin Horner: Sequentially, we were up 1 percent.

Mr. Jack Cronin: We were up 1 percent. And you know the growth in consultants on billing as, Kevin, I think you mentioned, is 3 percent.

Mr. Kevin Horner: Is 3 percent, right.

Mr. Michael Conti: So, were there any one-time factors impacting top-line growth? Were you guys impacted by weather at all with the hourly consultants, or--?

Mr. Kevin Horner: I don't know. I don't think our utilization rates were anything.

Mr. Jack Cronin: No, they were normal for the quarter.

Mr. Kevin Horner: Yes.

Mr. Michael Conti: Okay. Great. And just curious as to--you guys placing your consultants on these newer projects with the new clients rather going forward. Is there any--you find it, you know, to be difficult to maybe add or retain consultants to fill in those spots? Is there any, you know, I guess, headwinds going forward, or are you guys confident that you'll be able to retain enough consultants to, you know, actually fill the open positions?

Mr. Kevin Horner: Yes, let me answer that two ways. Let me start from a macro sense, Mike. The IT industry in the United States, on a year-over-year basis from Q1 '13 to Q1 '14, the IT industry has growth 2.4 percent. There are 2.4 percent more jobs starting in April 2014 than there were in 2013. So, that's a good news story, right? That's a good news story. Yes, in 2013 in total, I believe we added between 180 and 200,000 jobs to the U.S. IT economy, right? U.S. colleges and universities are graduating--they graduated the last--the last numbers I saw--and they were through Techserv. I forget the survey that they follow but it's a very specific industry, IT industry survey. It looks like the U.S. graduated about 30,000 people in a similar timeframe and has in total 50 to 60,000 people enrolled in colleges and universities. That's graduate and under--or that's graduate and undergraduate programs. If the industry's adding, somewhere between 150 and 200,000 jobs and the education system is out 30 or 50 or 60,000 people a year - is it going to get tougher to fill those jobs? Yes, yes, it is. It is. Frankly, why companies like ours- well, its part of the reason why we exist. That's why our clients want a good talent acquisition partner to work with because, you know, we find talent in places that others can't or that they can't for themselves or they don't for themselves. Our business model works pretty well in that we attract both U.S. citizens and U.S. right-to-work candidates as well as H1B candidates. We attract both of those. I think we are advantaged in that--in this situation where talent gets tighter and tighter and tougher and tougher to get. Do I believe it's going to get tougher? Yes, I do, Mike. I do. I believe we're finding that it's getting tougher. I believe the economics of the jobs world today, because the recovery in the U.S. has been so slow and so drawn out, and fundamentally, a jobless recovery in most industries other than IT, I mean, the IT industry's growing three times the rate that the rest of the U.S. economy is from a job standpoint. It's still tough to get bill rate increases out there and you can see it in the way people are reporting earnings. A lot of people making bottom-line numbers and not a lot of people making top line. We feel extremely fortunate to grow our top line 20 percent year over year when the markets forecasted to grow this year 7, 8 percent and, you know, the first folks out of the box yesterday reported a 10 percent down. So, I mean, that's a really long answer to your question, Mike, but do I believe it's going to get tougher? Yes, I do. I do. Yes, it's the games not for the faith of heart.

Mr. Michael Conti: Sure. Okay and lastly, do you have any clients that represented, more than 10 percent of revenues?

Mr. Kevin Horner: Yes.

Mr. Jack Cronin: Yes.

Mr. Kevin Horner: We do.

Mr. Jack Cronin: Yes, we have two. One represented 11 percent and one was 10.5. So, we had two clients in Q1.

Mr. Michael Conti: Okay. Can you guys share the names of those clients?

Mr. Jack Cronin: Sure. Sure. The number one was KPMG and the second was Accenture.

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

Mr. Kevin Horner: Great.

Operator: Thank you. The next question is coming from the line of Dave Polonitza with AB Value Management. Please proceed with your question.

Mr. Dave Polonitza: Hey, guys. Good morning. Good quarter there. Just a few questions. Wanted to know if you could break out the wholesale revenue number and also, did you repurchase any, stock during the quarter?

Mr. Jack Cronin: Yes with respect to the stock repurchases, we repurchased 19,341 shares and, the wholesale retail; we had total revenues of 28.7. We had revenues in the wholesale channel of 22.9 and the retail channel 5.8.

Mr. Dave Polonitza: Okay. Great. Was that stock repurchase done in the open market, or was that a private purchase?

Mr. Jack Cronin: It was actually, it was purchased through the vesting of restricted shares and the sale portion was dissatisfied tax obligations.

Mr. Dave Polonitza: Okay. Great. Kevin, if you could just comment, I think you mentioned that January started off a little bit weaker implying that the demand started to pick up as the quarter went on. How is the company positioning itself for basically the spring and summer of 2014 in terms of its recruiting capacity and the type of existing customer demand you see out there?

Mr. Kevin Horner: Yes, I'll give you a couple thoughts on there. Number one, on the recruiting capacity side, we have just gone through our second half of Q1, early Q2 and hiring process for our larger-scale recruiting centers in Noida and in Bangalore. We have recently added a significant number of folks to the organization through that process. So, I feel pretty comfortable with how that process has worked. In terms of demand for

Q2 and Q3, I don't see anything out of the norm on the demand front right now, Dave. I don't see anything like--we're not seeing anything huge or, we're not going to ring any bells. Okay? In the same breath, I'm not overly concerned at the moment either. I think if you looked at the data, our requisition levels in total for the business, our job requisition levels were down a bit in Q1 as compared to Q1 of last year. Our fill rates were better, so, we did a bit better on a--from a quality standpoint and our positions and job reqs are a bit up so far in Q2 but I wouldn't read anything into it. Yes, I wouldn't read anything into it.

Mr. Dave Polonitza: And just going back to one other thing, if I heard you right, Jack, you said wholesale was 22.9 and retail would be 5.8 million. Is that correct?

Mr. Jack Cronin: That's correct.

Mr. Dave Polonitza: What changes--because I think that's the first uptick in retail in awhile? What changes drove that increase in retail revenues?

Mr. Jack Cronin: I mean from a client perspective, it was just doing some more business with some of our MSPs.

Mr. Kevin Horner: Yes. The two dormant accounts that I talked about a minute ago, Dave, are both retail business, retail clients that we've done some business with in late Q4 and then again in Q1 - It could be as simple as that.

Mr. Dave Polonitza: Okay. Great. Appreciate it, guys.

Operator: Thank you. The next question is a follow up coming from the line of Howard Rosencrans with Value Advisory. Please proceed with your question.

Mr. Howard Rosencrans: Hi, guys. Just a quickie. You referred to the new initiative where you brought on or you're targeting 15 new customers and you added, or I guess that's the beginning of your targeting of new customers from the adding of personnel. We're always looking for bigger and better. Your SG&A ratio was a little bit up Q to Q. Have we seen pretty much the full impact or is there more of a lag from those hires, or should we start to see or hopefully get some leverage from those hires as we put ---- get new sales on from those 15 and others?

Mr. Kevin Horner: Well, the cost structure is very clearly indicative of the fact that we did bring new people on. We have salespeople in the organization in Q1 of this year that we did not have in Q1 of last year and, frankly, didn't have in Q4 of last year either. So, that really does explain some of the cost stuff, Howard. That's the design, right? The in this business, the cost happens before the revenue does, right? I'm not sure that's different from any other business but certainly this one works our SG&A cost hits first and then, hopefully, the revenue hits. So, that’s the bet we're making.

Mr. Howard Rosencrans: It works for us. So, that's [--Unintelligible--.]

Mr. Kevin Horner: [--Unintelligible--.]

Mr. Howard Rosencrans: Works for us, and it apparently works for you. I'm just trying to understand if we're--if we've seen pretty much the full-- Is there a bigger hire on the additional hires on the horizon this year, or have we seen pretty much the full impact?

Mr. Kevin Horner: We will continue to hire. Yes, we will continue to hire and we will continue--probably the single biggest hire that, in my view, will do this outside of kind of just the standard, sales and recruiting is we are going to hire somebody who will run that third leg of our growth strategy that's really all about building out, some technology talent in a focused technical platform or technical practice area. We will be bringing somebody in to do that.

Mr. Howard Rosencrans: Okay. Great. Keep up the great work. Thank you.

Mr. Kevin Horner: Thanks, Howard.

Operator: Thank you. And as a reminder, ladies and gentlemen, if you would like to ask a question at this time, please press star-one on your telephone keypad. Please hold while we poll for any additional questions. Mr. Horner, it appears there are no further questions at this time. I'd like to turn the floor back over to you for any additional concluding comments.

Mr. Kevin Horner: Thank you very much. So, considering there are no further questions, I'd like to thank you, all, for joining our call today. We look forward with sharing our second quarter 2014 results with you in late July. Thanks for the engaging call - it was actually a lot of fun today. So, thanks much and everybody have a great day. Take care.

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