Mastech Digital Inc.
Fourth Quarter 2020 Earnings Call
February 10, 2021

Operator
Greetings, and welcome to the Mastech Digital Inc. fourth quarter 2020 earnings call. At this time, all participants are on 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 "*" "0" on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host Ms. Jennifer Ford Lacey, Manager of Legal Affairs for Mastech Digital Incorporated. Thank you, Ms. Ford Lacey. You may now begin.

Jennifer Ford Lacey
Thank you, operator, and welcome to Mastech Digital's fourth-quarter 2020 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; Paul Burton, Chief Executive for Mastech InfoTrellis; 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 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 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 2019 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 non--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 2020 results. Jack.

Jack Cronin
Thanks, Jen, and good morning everyone. 2020 was a year of extraordinary challenges. We were confronted with the COVID-19 pandemic, its enormous impact on the global economy, and its devastating disruption to our day-to-day lives. With the rollout of global vaccination programs, we are now hopeful that a recovery is in sight. We are also extremely proud of how our organization and dedicated employees responded and adapted to these unprecedented times. This adaptability and focus is the foundation upon which our financial results for 2020 were built.

With that backdrop, let me now comment on our Q4 2020 financial performance. Revenues for the fourth quarter of 2020 totaled $48.7 million, compared to $50.4 million in the fourth quarter of 2019. Our Data and Analytics Services segment contributed record revenues during the quarter, albeit with the help of the AmberLeaf acquisition. And our IT Staffing Services segment achieved a 3% increase in consultants-on-billing during the quarter. This was the second consecutive quarter of expanding our headcount in the IT Staffing Services segment.

While there is still uncertainty in the marketplace, we are seeing positive signs of improvement in activity levels in both of our business segments. Gross profits in Q4 of 2020 totaled $13.1 million compared to $12.8 million in the same quarter of 2019. Thus, we had a 2% increase in gross margins despite a 3% decline in revenues. Our gross margins of 26.8% reflected an increase of 180-basis points over Q4 of 2019.

GAAP net income for Q4 2020 was $2 million or $0.17 per diluted share, compared to $2.3 million or $0.20 per diluted share in the fourth quarter of 2019. It should be noted that the 2020 quarter included $650,000 of pre-tax transaction expenses associated with the AmberLeaf acquisition.

Non-GAAP net income for Q4 of 2020 was $3.4 million or $0.29 per diluted share compared to $2.9 million or $0.26 per diluted share in the 2019 quarter. Fourth-quarter SG&A expense items not included in non-GAAP financial measures, net of cash benefits were 1), the amortization of acquired intangible assets; 2), stock-based compensation; and 3), acquisition transaction expenses, which are detailed in our Q4 earnings release and available on our website.

Addressing our full-year results, 2020 revenues totaled $194.1 million, a slight improvement compared to $193.6 million in 2019. Gross profits in 2020 were $51.5 million compared to $48 million in 2019, a 7% increase on essentially flat revenues. Gross margins as a percentage of revenues were a record 26.6% in 2020, which reflects an increase of 180 basis points over 2019. We believe that many companies in today's marketplace would be envious of such a gross margin performance.

GAAP net income for 2020 totaled $9.9 million or $0.83 per diluted share, compared to $11.1 million or $0.99 per diluted share in 2019. Again, it should be noted that the 2020 year included $650,000 of pre-tax acquisition transaction expenses, and the 2019 period benefited by $6.1 million of pre-tax gains from the revaluation of the contingent consideration liability.

Factoring in these two items, GAAP net income in 2020 clearly outperformed 2019. Non-GAAP net income for 2020 totaled $13.9 million or $1.16 per diluted share compared to $9.3 million or $0.82 per diluted share in 2019. The $1.16 earnings per share number was a record performance made particularly noteworthy because of the incredibly challenging macroeconomic environment experienced in 2020. Again, a detailed reconciliation of our non-GAAP financial measures compared to the comparable GAAP measures is included in our Q4 earnings release.

Addressing our financial position despite the challenges of COVID-19, we made material improvements in 2020. First, we protected our cash conversion metrics with respect to our largest assets, accounts receivable. During the year, we maintained a healthy Days Sales Outstanding measurement of 60 days and ended 2020 with no additions to our bad debt reserve. Additionally, we lowered debt levels and increased our cash balances on-hand even while incurring additional debt to support the AmberLeaf acquisition. At December 31, 2020, we had borrowing capacity under our revolving credit facility of approximately $22 million.

In summary, though our financial performance in 2020 was solid, it wasn't close to the high expectations that we had when we entered the year. And I can tell you that our entire organization is excited about the prospect and opportunity that lies before us for 2021.

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 2020.

Let me start by saying how delighted I am with both our Q4 and full-year 2020 financial performance. In my lifetime, there has never been such a disruptive environment as we experienced because of the COVID-19 pandemic. Fortunately, as an organization, we were quick to recognize the challenges at hand and implemented decisive actions in both of our business segments. We believe these actions proved effective in protecting gross margins, improving profitability, and mitigating the decline in our revenues. Our transition to a work-from-home model from the outset of the pandemic helped secure the safety of our employees and give us a resilience to continue to successfully service our clients.

We instituted aggressive, but fair austerity measures; we stood firm on pricing; and we resisted the temptation of lowering our credit standards. In summary, we acted quickly, we stuck to our principles, and we navigated the challenges from a position of relative strength. Accordingly, our financial performance was strong, and more importantly, we believe we are well-positioned today to excel as the global recovery takes hold.

As Jack mentioned, our Data and Analytics business segment delivered record revenues in both Q4 and for the full-year of 2020. We also closed the acquisition of AmberLeaf on the very first day of the fourth quarter. Paul will talk about this segment's performance in his comments shortly.

Let me now share a few highlights of our IT Staffing Segment's performance in 2020. 1), we mitigated revenue declines. While our IT staffing revenues did decline in 2020, we did an admirable job in mitigating this decline. We were in front of our clients early to address their challenges. We launched a new service offering branded as MAS-REMOTE, which provides our clients with highly skilled resources across the U.S. and Canada and as a result, we achieved an increase in our billable consultant base during the second half of 2020 and have begun to recover from the headcount decline experienced in the first half of the year.

2), we protected our gross margins. Throughout the pandemic, we continued to focus on digital technologies, which in turn continued to expand our gross margins. Our MAS-REMOTE service offering allowed us to provide our clients with a compelling value proposition, further protecting gross margins from pricing pressures. And 3), we increased our profitability. Timely and aggressive austerity measures drove strong net income in 2020 despite the many challenges brought on by the global pandemic. It's also important to note that our austerity measures were strategically implemented with the goal that we would be well-positioned from a staffing and cost perspective to capitalize on a recovery in the U.S. economy. I'm confident that this objective was clearly achieved as we sit here today.

I will now turn the call over to Paul for his comments on our Data and Analytics Services segment.

Paul Burton
Thanks, Vivek, and good morning everyone.

There is no doubt that the global pandemic disrupted our performance in 2020. Nevertheless, despite the pandemic, we were able to post solid, solid growth in Q4, and net of the AmberLeaf acquisition, we achieved 6% top-line growth for the full year as well as the highest bookings we've ever had. Net of the AmberLeaf acquisition, we also posted record gross margins for the full year and profit, which measured as a percentage of revenue, came in ahead of 2019.

In 2020, we lost no key clients, and some significant deals that were delayed have already closed in 2021. We are optimistic that the effect of the pandemic on the macro-economy will reduce in 2021, and the new offerings and capabilities that we developed in 2020 will take hold and propel us to even greater growth and profitability this year.

As you know, on October 1 of 2020, we announced the completed acquisition of Amber Leaf, a client experience consulting firm. We completed the integration of AmberLeaf into the Data and Analytics business in Q4 and now, we anticipate that the combined capabilities of the two businesses will take hold and produce larger opportunities in new and existing clients. Indeed, we are already seeing significant traction in deal closures due in part to these capabilities and have reason to be hopeful that this will continue.

However, as important as AmberLeaf was in helping us fill out the proposition of value that we take to our clients, we see additional focused opportunities in the market that can help us move even more quickly to meet the urgent needs that our clients have related to cloud computing, application modernization, and enterprise intelligence. We remain alert to such opportunities and cognizant of the need to move quickly and efficiently to meet the developing needs of our clients and to respond to emerging market trends. We are simply not seeing the slow or the lethargic being rewarded in this market.

Finally, as we enter 2021, we are seized with a pipeline of high-value opportunities. As I mentioned a moment ago, we are already seeing engagements that slipped from last year close, particularly in Europe and Asia. And our key partnerships not only remain solid but they are showing significant signs of improvement based on public announcements. For example, IBM recently announced it would invest substantially in its partner Cloud Ecosystem.

With vaccinations for COVID accelerating and our strong capabilities offerings and pipelines, we see substantial reason for optimism in 2021. This concludes our prepared remarks, and now operator, you can open the session for questions.

Operator
Thank you. Ladies and gentlemen, the floor is now open for questions. If you would like to ask a question, please press "*" "1" on your telephone keypad. A confirmation tone will indicate that your line is in the question queue. You may press "*" "2" if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handsets before pressing the "*" keys. Once again, that is "*" "1" to register questions at this time.

Our first question is coming from Josh Vogel of Sidoti and Company. Please go ahead.

Josh Vogel
Thank you. Good morning, Vivek, Jack, and Paul. Thanks for taking my questions. First one, I know you've been investing in the business, notably in the Data and Analytics sales team, and maybe this is a dual question for Jack and Paul, but when we think about areas of internal investment in 2021, where will you be looking to spend, and, you know when, and, you know, how much relative to prior years?

Jack Cronin
So, I'll go--you are talking about internal investment. Correct?

Josh Vogel
Yes. Yes.

Jack Cronin
We're seeing a tremendous amount of demand for managed services in the Data and Analytics space, as well as in cloud computing application modernization, as I mentioned in my remarks. And investments it would certainly seem appropriate to tailor internal investments towards building out and hardening managed services capabilities so that we can support clients 24/7 as we're currently seeing demand in the marketplace. So, certainly, investments around managed services, which would have a multiplier effect for annuity revenue, would be I think appropriate.

Josh Vogel
All right, great. And when we think about the aggressive austerity measures - I want to kind of get a sense of how much can be permanent? How much may come back mid-year? Also, I know you don't give guidance, but any sort of directional commentary around sense of how the gross margin could look this year, as the year progresses, and certainly as D&A and digital become bigger pieces of the revenue mix?

Paul Burton
I can take a crack at that, Josh, we don't give guidance but with respect to gross margins, just because of the blend of the revenues between D&A and staffing - clearly, we expect our margins in 2021 to expand.

Vivek Gupta
And if I may add over here, the austerity measures that we took in the beginning of 2020 were, timely, but we also were very pragmatic about not cutting the cost down so much that it would hurt us when the recovery came. So, we've actually maintained a pretty healthy producer level. And this year, there will, of course, be some increase in the costs, because as we recover and scale.

But I don't anticipate that we will go back to the pre-COVID levels in terms of those cost investments. If this answers the question that you were asking, Josh?

Josh Vogel
Yes. That's helpful. Thank you. And Vivek, you--obviously very impressive how well the business held up last year and the margin expansion and you mentioned how you stood by your pricing discipline, and I'm just curious if you lost any significant opportunities or business because--because you were so disciplined with pricing?

Vivek Gupta
Josh, I see surprisingly no. I think there was that spirit of cooperation between the customers and ourselves, and the ones who were putting pricing pressure, they actually had genuine reason for doing that because they were grappling with their own demons as the pandemic was affecting every industry.

But I think we were able to work out, with customers, and having, some--an offering like MAS-REMOTE helped us as well in managing or managing the pricing. So, we really didn't lose any customers on account of pricing. We may have had some engagements coming to an end because the customers had issues with their budgets and other pressures that they have had.

Jack Cronin
If we lost clients, it wouldn't be clients that we were overly concerned of losing. I mean, it would be the--the low margin stuff, and we're really not interested in that.

Josh Vogel
Yes. Understood. And then, just lastly, Paul, you made a comment around some deals that were delayed have already closed in 2021. Can you just give us a sense of the size or amount? I know back, I guess it was December 2019, you kind of put--you quantified, you know, how much new business was signed, just want to get a sense of what--what closed already in '21? Thank you.

Paul Burton
Yes. So, we had three particular deals in Europe and Asia that we are anticipating closing in Q3 and then Q4 but because of reasons associated with the pandemic they kept getting delayed and ultimately push to this year. We have since closed in January, two deals in Asia and one deal in Europe of significant size. I don't want to disclose the number in particular but well over $1 million.

Josh Vogel
Great. Thank you guys again for taking my questions.

Vivek Gupta
Thanks, Josh.

Operator
Once again, ladies and gentlemen that's "*" "1" to register a question at this time. Our next question is coming from Lisa Thompson of Zacks Research--Zacks Investment Research. Please go ahead.

Lisa Thompson
Good morning.

Vivek Gupta
Good morning.

Lisa Thompson
I want to talk a little bit about the fourth quarter and how you see business going into the first quarter and into 2021. I feel like staffing didn't come back as quickly as we had hoped by the end of this year and I was wondering what you felt about sequential like staffing has gone down in revenues last three quarters, do you expect that to stop happening and to start growing again sequentially?

Vivek Gupta
Lisa, yes, after a drop at the end of Q1, the staffing revenues have pretty much held up around the $40 million revenue kind of mark. We did have a growth in headcount in Q4, but our business the actual benefit of that comes in the following quarter. And seasonally Q4 also a quarter in which we have a lot of holidays and furloughs towards the end of the year etc.

So that always impacts the revenue that we can get with the number of consultant base that we have. We are - definitely, things are looking up, and Q1 should be better than, and we should start seeing the improvement come in. I can’t comment on the exact amount, but, yes, definitely that we should benefit of the additions that we have had in the headcount in the last two quarters.

Lisa Thompson
Okay, that’s good to hear. And I look at Data and Analytics in Q4 at $8.9 million, and you obviously ended--added a quarter of Amber, which should be about, I don’t know, $2 million--$2.5 million. It seems like it was fairly weak for the rest of the business, or is there something going on there that I don’t know?

Paul Burton
No, it was $6.8 million and $2.1 million totaling $8.9 million, and as I said that we saw significant deal delays in the fourth quarter primarily related to the pandemic and particularly harsh shutdowns in Europe and Asia. And as a result, we had deals slip out, which I’ve already noted that closed in Q1. So, Q4 was a good quarter. It was not a record quarter for the core business. We saw substantial increases in pipeline.

We improved margin, improved EBITDA, so overall it was a very solid quarter. Customers continue to have differing behaviors as they relate to the pandemic, but we are seeing the effects of the pandemic reduce, especially with the light at the end of the tunnel represented by vaccines and their distribution. So we're very optimistic going forward.

Lisa Thompson
Okay. And on AmberLeaf, you had talked about how you could potentially improve their margins either through, you know, synergies or just repricing? Can you talk about where you are in that process?

Paul Burton
Yes, the integration of AmberLeaf was completed in Q4, which essentially means that they're running on our processes and policies, and we have an integrated go-to-market operating model with them. We do anticipate and are seeing margins improve for the overall business.

I would anticipate that some of the opportunities and work of an annuity nature for AmberLeaf can be serviced nearshore and offshore. So overall, we do expect the margins to improve going forward.

Lisa Thompson
Okay. So, you still have some even after this quarter?

Paul Burton
Some--some what after this quarter.

Lisa Thompson
Improvement in margin like cost-cutting?

Paul Burton
Oh, yes. The integration was effectively completed in fourth quarter so, now first quarter onwards, we're going to start seeing the upward trend of increasing margins.

Lisa Thompson
Okay, good. So, Jack taking that and just applying it to SG&A, can we just take like the fourth quarter SG&A and subtract the 650 one-time and expect it to be at that level or lower in Q1?

Jack Cronin
Well, I would say that our activity levels are clearly increasing in staffing for sure. We had the 3% COB growth and in D&A, our pipeline, our bookings, our backlog have increased in Q4. So, there is clearly going to be some ramp-up of SG&A to support what we think is going to be an increase in activity levels and revenues in Q1.

I think that if you did the math that you talked about to come up with the baseline Q4 number we're going to be a little bit higher than that in Q1.

Lisa Thompson
Okay, all right. So, is there anything you can just kind of broad-base talk about how you expect 2021 to look versus 2022 either far as revenue growth or expenses? Just it seems like you could really come roaring back, or it could just trickle in slowly. What are you're feeling on how it's going to play out?

Vivek Gupta
Lisa, we are, I guess, still in the pandemic. We are not out of it. So, the uncertainties are still there. So, it's hard to actually give a very precise projection as to what the year will look like. But, definitely, this year is going to be the year of recovering for the staffing business and, going

beyond in terms of beginning the scaling. And on the data analytics side, it's definitely going to be scaling from where we have reached.

This is at the top-line level, and SG&A will increase, which is what Jack just mentioned and how the whole thing plays out, it's still not that clear. So, that is the intent, and that is the direction the organization and the two segments are taking. I don't know if that answers your--

Lisa Thompson
Yes, a little bit. I just to compare with last quarter, you talked a little bit about how international was shutdown, in certain countries you couldn't even travel in, has anything improved or is everything still in the same situation?

Paul Burton
Well, Europe had a very hard shutdown, and Asia shut down early, probably going back to March, April, and they have remained shut down. So, Europe and Asia are our two major markets outside of the U.S. are very hard shutdowns. And as a result, we saw a lot of pipeline and a lot of deals, which we would have expected to close much earlier get delayed and pushed as I've mentioned, some of those have already closed.

The shutdown is still in effect in these places, but what I think you've seen is businesses need to continue to be businesses, and they've adapted and figured out how they're going to proceed, given the shutdown in terms of running their business, continuing to build out capabilities and infrastructures. So, I think there was certainly a period of time where businesses were trying to assess what was going on and how long was this is going to last? What should I do with investments in terms of continuing or postponing etc., different sectors relating to it different ways.

I think it's a sort of a well-known quantity at this point everyone understands how to work in this environment after about nine months of doing it. And unless there is a material degradation in the environment, the vaccines don't work, the pandemic gets worse, there's a mutation something weird happens I think we are on the upswing, and we should see things improve.

Lisa Thompson
Okay. Great. That makes a lot of sense. Thank you. That's all my questions.

Vivek Gupta
Thanks, Lisa.

Operator
And gentlemen, if you do have a question, please press "*" "1" on your telephone keypad. One moment please, while we poll for additional questions.

We’re showing no additional questions in queue. At this time, I'd like to turn the floor back over to Mr. Gupta 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. Stay safe, and we look forward to sharing our first quarter 2021 results with you in late April. Thank you.

Operator
Ladies and gentlemen, thank you for your participation. This concludes today's event. You may disconnect your lines or log off the webcast at this time, and have a wonderful day.