MASTECH

Mastech Second Quarter Earnings Call

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Operator: Greetings and welcome to Mastech Second Quarter 2015 Earnings Call.

At this time, all participants are in a listen only mode. A brief question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please push star, zero on your telephone keypad. As a reminder, this conference is being recorded.

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

Ms. Jennifer Ford Lacey: Thank you, Adam, and welcome to Mastech's Second Quarter 2015 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 and uncertainties that could cause actual events to differ materially from these forward-looking statements, including those listed in the company's 2014 Annual Report on

Form 10-K, filed with the Securities and Exchange Commission and available on their website at www.sec.gov.

As a reminder, we will not be providing guidance during this call, nor will we provide guidance in any subsequent one-on-one meetings or calls.

I will now turn the call over to Jack for a review of our second quarter 2015 results.

Mr. Jack Cronin: Thanks, Jen, and good morning. First off, I'm pleased to inform everyone that we completed our acquisition of Hudson Global's US IT staffing business on June 15th, 2015. Accordingly, Hudson IT's financial performance from the closing date through the end of second quarter are included in our overall Q2 2015 results. As a point of reference, Hudson IT revenues and net income included in our second quarter 2015 consolidated numbers approximated 1.3 million and $70,000 respectively.

As you may have noticed, management has elected to provide 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.mastech.com.

Addressing our financial results, revenues for the second quarter of 2015 totalled $29.3 million compared to $27.7 million during the second quarter of 2014. Our revenue increase largely reflected the consolidation of Hudson IT. Exclusive of the 206 consultants on billing that we acquired with the acquisition, we modestly grew organically our COBs during the quarter. Additionally, our average bill rate for the second quarter of 2015 approximated $75 per hour, or about 2 percent higher than in the corresponding quarter of 2014.

Activity levels were generally flat from the previous quarter. However, we did improve our assignment win rate from last quarter, which resulted in some COB growth in Q2.

Gross profits for the second quarter of 2015 totalled $5.5 million, or 18.8 percent of revenues, compared to $5.1 million, or 18.5 percent of revenues, during the same period last year. Our gross profit dollar improvement reflected the additional revenue volumes from Hudson IT as well as the higher overall gross margin percentage. Our second quarter 2015 gross margin percentage rebounded nicely from the previous quarter's 17.3 percent GM performance.

As we mentioned on our last call, while we were largely unsuccessful in securing bill rate increases on existing assignments to cover increased benefit costs associated with the Affordable Care Act, we did however adjust our pricing model to recover these higher benefit costs on new assignments. What we're seeing in Q2 is higher GM on new assignments replacing lower GM on assignments that ended during the quarter.

GAAP net income for the second quarter of 2015 was $382,000, or 9 cents per diluted share, compared to $893,000, or 20 cents per diluted share in the second quarter of 2014. Non-GAAP net income for the second quarter of 2015 was $801,000, or 18 cents per diluted share, compared to $947,000, or 21 cents per diluted share in the corresponding quarter of 2014.

Q2 SG&A expense items not included in the non-GAAP financial measures net of tax benefits were, one, amortization of acquired intangible assets, two, acquisition transaction cost, and, three, stock based compensation.

Addressing our financial position, at June 30th, 2015, we had $13.4 million of outstanding bank debt net of cash balances on hand. The increase in debt during the quarter reflected the funding of our $17 million cash purchase price for the Hudson IT business. Our borrowing availability at quarter-end approximated $8.3 million. During the quarter, we expanded our credit facility with PNC Bank by $6 million -- total $26 million facility in support of our acquisition and ongoing cash needs. We also extended the revolving loan component of the facility, which totals $17, through June 15th, 2018, and the term loan component, which totals $9 million, through June 15th, 2020.

Principle repayment requirements under the term loan total $150,000 per month, or $1.8 million annually, over a five year period. The effective interest rate incurred in June 2015 on outstanding borrowings was slightly less than 3 percent per annum.

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

Mr. Kevin Horner: Thanks, Jack, and good morning, all. First I would like to comment on our second quarter 2015 performance, and then I'll give you some of my thoughts on our recent acquisition of Hudson IT.

On the heels of a large scale change to our sales organization in late Q1, I'm feeling rather positive about how the organization responded to that change. Additionally, I feel good about several key components of our operating performance in the quarter.

First and foremost, we were able to achieve positive growth in the number of consultants on billing during the quarter. The majority of our new consultants on billing came directly from the acquisition of Hudson IT. But, just as importantly, we also had organic COB growth in the quarter, as well.

The key for me moving forward is our ability to minimize disruption to the business as we integrate Hudson IT into Mastech and at the same time drive sales and recruitment performance from our legacy business.

I'm also very pleased with our initiative to improve our gross margins by being more disciplined with respect to profit content on new assignments. Gross margins in the second quarter 2015 improved a full 150 basis points over the previous quarter. While Q1 is historically a lower GM quarter due to higher payroll tax expense, the extent of our increase was very satisfying to me. We made specific changes in pricing policies and pricing processes to ensure we recovered all the additional cost related to ACA, and we pushed our teams hard on securing better pricing on new deals and on extensions in recognition of the extremely tight candidate market.

Additionally, we materially closed the year-over-year earnings gap that we experienced in the first quarter of 2015. Just to reinforce what Jack has already communicated, our second quarter non-GAAP diluted earnings per share was 18 cents, which was 3 cents below Q2 2014's non-GAAP equivalent. On a non-GAAP basis, diluted earnings per share in Q1 of 2015 were 10 cents below the corresponding 2014 period. Thus, we closed 7 cents of that 10 cent year-over-year gap in diluted earnings per share during the second quarter. My view - good progress made sequentially in Q2 2015 plus a good platform to build on for the remainder of 2015.

Now, let me take a minute to say a few words about our recent acquisition of Hudson IT. With the June 15th acquisition of Hudson IT, I'm excited about the opportunities this transaction brings to Mastech. First, the acquisition jumpstarts our retail channel revenues with Hudson's healthy portfolio of direct end user clients and their relationship selling model that caters to the market dynamics of a retail client.

Secondly, it provides growth opportunities for our newly combined company by leveraging the strength of our offshore recruiting model directly into the Hudson retail business. Third, we get the benefit of learning the retail business and the relationship selling skills across the existing Mastech sales organization. And finally, the acquisition brings seasoned talent to Mastech, not only in the form of business leadership, but throughout the sales and recruitment organizations, as well. I've spent a lot of time over the last few months with the Hudson organization and experienced firsthand the talented and committed employees, which I'm delighted to say are now an integral part of Mastech's future.

When I sum up the merits of the Hudson acquisition, I think about it in very simple terms. The combination of our businesses allows us to capitalize on our collective strengths. It's a classic acquisition opportunity where one plus one can really equal more than two.

At this time, I'd like to open it up for your questions.

Operator: Thank you. We will now be conducting a question and answer session. If you would like to ask a question, please push star, one on your telephone keypad now. A confirmation tone will indicate your line is in the question queue. You may push star, two if you would like to remove your question from the queue. For any participant using speaker equipment, it may be necessary to pick up your handset before pushing the star key. One moment while we poll for questions.

Our first question comes from the line of David Polonitza with AB Value Management. Please go ahead with your question.

Mr. David Polonitza: Hi, Guys. Good morning.

Mr. Kevin Horner: Good morning, Dave.

Mr. David Polonitza: Wanted to ask a couple questions, you are only about a month into fully--or six weeks into fully, kind of closing the acquisition. But, you know, post acquisition, even though it's early on, have you been able to strengthen Hudson IT now or begin the process of strengthen now that it's in the 100 percent focused IT staffing environment?

Mr. Kevin Horner: Dave, I'll answer that a couple of different ways. Number one, the way you asked the question, I know you know the first answer is going to be we're really too early into the process to make any comments that are definitive. Secondly, I would also say that to date, I think, we've seen some initial successes with the direct retail business that Hudson had with several clients, which was more MSP oriented and fits direct with Mastech's offshore recruiting model.

We have been able to begin to work some business that generally the Hudson team in their past structure was really unable to work. So too early to tell, but some of the immediate synergies that we saw in the deal are beginning to play themselves out.

Mr. David Polonitza: All right. I'll just ask one more question here and step aside. I'm sure it'll take a while to fully integrate and execute on this acquisition. But, over the longer term horizon, if you're able to successfully leverage your centralized recruiting model, in this retail environment, is there any reason why Mastech can't kind of further supplement its platform with additional acquisitions along the line of a Hudson IT?

Mr. Kevin Horner: Again, really early into the game Dave, I think it is clearly a possible outcome to where we could take this process. But, I hesitate to create expectations before we've got a couple of quarters under our belt and we know what things begin to look like.

So, I hate to give you such a non-committal response, but, theoretically, I think the answer to your question's yes.

Mr. David Polonitza: --Sure--

Mr. Kevin Horner: I don't want to try to create expectations for anyone on the call or anyone who will read the transcript later that we're out looking for the next one because, frankly speaking, we're working really hard to get this one integrated and positioned inside of Mastech so that we capture all of the benefits that Hudson brings with it, and don't create any disruption.

Mr. David Polonitza: Sure. No, I appreciate that and thanks for the information, and pretty good quarter.

Mr. Kevin Horner: Thank you.

Operator: Thank you. Ladies and gentlemen, as a reminder, if you would like to ask a question, please push star, one on your telephone keypad now. One moment while we poll for more questions.

Our next question is a follow up from David Polonitza with AB Value Management. Please go ahead with your follow up.

Mr. David Polonitza: I think I might be the only one to ask a question here, so let me just ask one more. What changed or what were you able to do--I think you alluded to it a little bit--to bring back organic growth to what Mastech pre-acquisition? Going forward, do you believe the pieces are in place, generally over the long run, to continue an organic growth trend for what Mastech was prior to the acquisition.

Mr. Kevin Horner: Yes, that's a good question, Dave. I think there are several things that have changed and continue to change right now. First and foremost, in some respects, the staffing business is fairly simple. It's really all about activity on both sides of the organization. From a selling standpoint, it's about bringing new good requisitions for jobs into the organization and that's from both current customers and new customers, and it's about activity on the recruiting side. It's about building relationships with potential candidates and submitting candidates to job requisitions.

In many respects, we're not doing brain surgery, right? It's a pretty straightforward business. And activity has begun to increase as we sit here today and as we move forward. So, I think, we begin to get positioned to continue to grow organically.

Mr. Dave Polonitza: Okay.

Mr. Kevin Horner: I think the thing that we have to be careful of, as you all know, any time an acquisition happens, there's a massive amount of change that goes on, frankly, for the entirety of the organization, for--the legacy portion of the organization goes through change and, the new part of the organization goes through change. The key for all of us is to ensure that we're not creating disruption that would slow down any of the business activity that I talked about a minute ago.

So, that's where we are in the third quarter is we are really pushing hard to manage that change related to the organization and to not allow any disruptions in the business to creep in.

Mr. David Polonitza: Great. One question for Jack. In terms of the debt that the company has currently, is there anything, or are there any covenants or reasons why, if Mastech desires, it can, you know, pay down the debt faster than currently scheduled, because it looks like you've done a pretty decent job, since the acquisition, paying some of that down already?

Mr. Jack Cronin: Yes, I think we have. Again, at the end of the quarter, on the revolver side, we had availability of $8.3 million. Our debt requirements on the term are 1.8. We're cash flow positive. I mean, we feel pretty comfortable with the debt service requirement, and we have covenants we've negotiated covenants with, PNC that gives us, good room on--from a leverage standpoint and a fixed charge ratio. So, we feel pretty good.

Mr. Kevin Horner: Dave, my only add to that was I was with our representative from PNC on Monday, and frankly, he was a bit surprised that Jack's team was able to pay down as much as we had already paid down in the five weeks that since we've done the acquisition.

Mr. David Polonitza: Sure. No, it was good number. I was surprised at that number in a good way.

Mr. Kevin Horner: Yes

Operator: Thank you. Ladies and gentlemen, once again, as a reminder, if you would like to ask your question, please push star, one on your telephone keypad now. One more moment while we poll for questions.

Ladies and gentlemen, we have no further questions in the queue at this time. I would like to turn the floor back over to management for closing remarks.

Mr. Kevin Horner: Thank you. Given there are no further questions, I would like to thank everybody for joining the call today. We look forward to sharing our third quarter 2015 results with you in late October. Everyone have a great day.

Operator: Thank you, ladies and gentlemen; this does conclude our teleconference for today. You may now disconnect your lines at this time. Thank you for your participation, and have a wonderful day.