

Mastech Digital, Inc.
Form 10-Q
May 11, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the quarterly period ended March 31, 2018

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

Commission File Number 001-34099

MASTECH DIGITAL, INC.

(Exact name of registrant as specified in its charter)

PENNSYLVANIA
(State or other jurisdiction of
incorporation or organization)

26-2753540
(I.R.S. Employer
Identification No.)

1305 Cherrington Parkway, Building 210, Suite 400

Moon Township, Pennsylvania
(Address of principal executive offices)

15108
(Zip Code)

Registrant's telephone number, including area code: (412) 787-2100

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or emerging growth company. See definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of the registrant's Common Stock, par value \$.01 per share, outstanding as of April 30, 2018 was 5,461,712.

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****MASTECH DIGITAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Amounts in thousands, except per share data)****(Unaudited)**

	Three Months Ended March 31,	
	2018	2017
Revenues	\$ 43,333	\$ 33,100
Cost of revenues	33,072	26,891
Gross profit	10,261	6,209
Selling, general and administrative expenses	7,823	5,806
Income from operations	2,438	403
Interest income (expense), net	(473)	(102)
Other income (expense), net	(39)	21
Income before income taxes	1,926	322
Income tax expense	546	121
Net income	\$ 1,380	\$ 201
Earnings per share:		
Basic	\$.25	\$.04
Diluted	\$.25	\$.04
Weighted average common shares outstanding:		
Basic	5,461	4,499
Diluted	5,529	4,561

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents**MASTECH DIGITAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Amounts in thousands)****(Unaudited)**

	Three Months Ended March 31,	
	2018	2017
Net income	\$ 1,380	\$ 201
Other comprehensive income:		
Net unrealized gain on interest-rate swap contracts	122	11
Foreign currency translation adjustments	(42)	
Total pretax net unrealized gain	80	11
Income tax expense	31	5
Total other comprehensive income, net of taxes	\$ 49	\$ 6
Total comprehensive income	\$ 1,429	\$ 207

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents**MASTECH DIGITAL, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Amounts in thousands, except share and per share data)****(Unaudited)**

	March 31, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,267	\$ 2,478
Accounts receivable, net of allowance for uncollectible accounts of \$408 in 2018 and \$398 in 2017	24,784	22,876
Unbilled receivables	8,777	7,786
Prepaid and other current assets	868	1,533
Total current assets	35,696	34,673
Equipment, enterprise software, and leasehold improvements, at cost:		
Equipment	1,411	1,395
Enterprise software	2,100	1,986
Leasehold improvements	365	365
	3,876	3,746
Less accumulated depreciation and amortization	(1,902)	(1,847)
Net equipment, enterprise software, and leasehold improvements	1,974	1,899
Deferred income taxes	475	468
Non-current deposits	294	255
Goodwill	35,844	35,844
Intangible assets, net	24,772	25,465
Total assets	\$ 99,055	\$ 98,604
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 4,194	\$ 4,003
Current portion of contingent consideration liability	6,125	
Accounts payable	4,395	5,028
Accrued payroll and related costs	7,129	8,969
Other accrued liabilities	2,296	1,679
Deferred revenue	191	430
Total current liabilities	24,330	20,109

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Long-term liabilities:		
Long-term debt, less current portion, net	34,968	34,149
Contingent consideration liability, less current portion	11,000	17,125
Long-term accrued income taxes	68	68
Total liabilities	70,366	71,451
Commitments and contingent liabilities (Note 5)		
Shareholders' equity:		
Preferred Stock, no par value; 20,000,000 shares authorized; none outstanding		
Common Stock, par value \$.01; 125,000,000 shares authorized and 6,282,348 shares issued as of March 31, 2018 and 6,281,235 as of December 31, 2017	63	63
Additional paid-in-capital	20,411	20,304
Retained earnings	12,303	10,923
Accumulated other comprehensive income	66	17
Treasury stock, at cost; 820,636 shares as of March 31, 2018 and as of December 31, 2017	(4,154)	(4,154)
Total shareholders' equity	28,689	27,153
Total liabilities and shareholders' equity	\$ 99,055	\$ 98,604

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents**MASTECH DIGITAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Amounts in thousands)****(Unaudited)**

	Three Months Ended March 31,	
	2018	2017
OPERATING ACTIVITIES:		
Net income	\$ 1,380	\$ 201
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Depreciation and amortization	748	252
Bad debt expense	10	
Interest amortization of deferred financing costs	22	9
Stock-based compensation expense	105	107
Deferred income taxes, net	(7)	8
Loss of disposition of fixed assets		4
Working capital items:		
Accounts receivable and unbilled receivables	(2,909)	(2,275)
Prepaid and other current assets	756	(23)
Accounts payable	(633)	989
Accrued payroll and related costs	(1,840)	(2,365)
Other accrued liabilities	617	(50)
Deferred revenue	(239)	(111)
Net cash flows (used in) operating activities	(1,990)	(3,254)
INVESTING ACTIVITIES:		
Payment for non-current deposits	(39)	(6)
Capital expenditures	(130)	(37)
Net cash flows (used in) investing activities	(169)	(43)
FINANCING ACTIVITIES:		
Borrowings on revolving credit facility, net	1,941	3,794
(Repayments) on term loan facility	(953)	(450)
Proceeds from the exercise of stock options	2	
Net cash flows provided by financing activities	990	3,344
Effect of exchange rate changes on cash and cash equivalents	(42)	
Net change in cash and cash equivalents	(1,211)	47

Cash and cash equivalents, beginning of period	2,478	829
Cash and cash equivalents, end of period	\$ 1,267	\$ 876

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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MASTECH DIGITAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2018 AND 2017

(Unaudited)

1. Description of Business and Basis of Presentation:

Basis of Presentation

References in this Quarterly Report on Form 10-Q to we , our , Mastech Digital , Mastech or the Company refer collectively to Mastech Digital, Inc. and its wholly-owned operating subsidiaries, which are included in these Condensed Consolidated Financial Statements (the Financial Statements).

Description of Business

We are a provider of Digital Transformation IT Services.

Our portfolio of offerings includes data management and analytics services; other digital transformation services such as Salesforce.com, SAP HANA, and Digital Learning services; and IT staffing services that span across digital and mainstream technologies.

Reflective of our recent acquisition of the services division of Canada-based InfoTrellis, Inc., we have added specialized capabilities in delivering data management and analytics services to our customers globally. This business offers project-based consulting services in the areas of Master Data Management, Enterprise Data Integration, Big Data and Analytics, and Digital Transformation, with such services delivered using on-site and offshore resources.

Our IT staffing business combines technical expertise with business process experience to deliver a broad range of staffing services in digital and mainstream technologies. Our digital technologies include data management, analytics, cloud, mobility, social and artificial intelligence. We work with businesses and institutions with significant IT spending and recurring staffing service needs. We also support smaller organizations with their project focused temporary IT staffing requirements.

Accounting Principles

The accompanying Financial Statements have been prepared by management in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and applicable rules and regulations of the Securities and Exchange Commission (the SEC). Accordingly, they do not include all of the information and disclosures required by U.S. GAAP for complete consolidated financial statements. In the opinion of management, all adjustments, consisting principally of normal recurring adjustments, considered necessary for a fair presentation have been included. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the Financial Statements and the accompanying notes. Actual results could differ from these estimates. These Financial Statements should be read in conjunction with the Company s audited consolidated financial statements and accompanying notes for the year ended December 31, 2017, included in our Annual Report on Form 10-K filed with the SEC on March 23, 2018. Additionally, our operating

results for the three months ended March 31, 2018 are not necessarily indicative of the results that can be expected for the year ending December 31, 2018 or for any other period.

Principles of Consolidation

The Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

Critical Accounting Policies

Please refer to Note 1 Summary of Significant Accounting Policies of the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates in our Annual Report on Form 10-K for the year ended December 31, 2017 for a more detailed discussion of our significant accounting policies and critical accounting estimates. There were no material changes to these critical accounting policies during the three months ended March 31, 2018.

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Segment Reporting

The Company has two reportable segments, in accordance with ASC Topic 280 Disclosures About Segments of an Enterprise and Related Information : Data and Analytics Services and IT Staffing Services.

2. Revenue from Contracts with Customers

As of January 1, 2018, the Company adopted Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, using the modified retrospective method. The core principle of the new standard is that a company should recognize revenue to depict the transfer of promised services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those services. The implementation of the new standard had no impact on the measurement of recognition of revenue of prior periods and we expect the impact of this new standard to be immaterial to us on an ongoing basis. Additional disclosures have been added in accordance with the ASU.

The Company recognizes revenue on time-and-material contracts as services are performed and expenses are incurred. Time-and-material contracts typically bill at an agreed-upon hourly rate, plus out-of-pocket expense reimbursement. Out-of-pocket expense reimbursement amounts vary by assignment, but on average represent less than 2% of total revenues. Revenue is earned on a per transaction or labor hour basis, as that amount directly corresponds to the value of the Company's performance. Revenue recognition is negatively impacted by holidays and consultant vacation and sick days.

The Company recognizes revenue on fixed price contracts as services are rendered and uses a cost-based input method to measure progress. Determining a measure of progress requires management to make judgments that affect the timing of revenue recognized. Under the cost-based input method, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the performance obligation. Revenues, including estimated fees or profits, are recorded proportionally as costs are incurred. The company has determined that the cost-based input method provides a faithful depiction of the transfer of goods or services to the customer. Estimated losses are recognized immediately in the period in which current estimates indicate a loss. We record deferred revenues when cash payments are received or due in advance of our performance, including amounts which may be refundable.

We do not sell, lease or otherwise market computer software or hardware, and essentially 100

% of our revenue is derived from the sale of data and analytics, IT staffing and digital transformation services. We expense sales commissions in the same period in which revenues are realized. These costs are recorded within sales and marketing expenses.

Our data and analytics services segment provides specialized capabilities in delivering data management and analytics services to customers globally. This business offers project-based consulting services in the areas of Master Data Management, Enterprise Data Integration, Data and Analytics and Digital Transformation, which can be delivered using onsite and offshore resources.

Our IT staffing business combines technical expertise with business process experience to deliver a broad range of services in digital and mainstream technologies. Our digital technology stack includes data management and analytics, cloud, mobility, social and automation. Our mainstream technologies include business intelligence / data warehousing; web services; enterprise resource planning & customer resource management; and e-Business solutions. We work

with businesses and institutions with significant IT-spend and recurring staffing needs. We also support smaller organizations with their project focused temporary IT staffing requirements.

The following table depicts the disaggregation of our revenues by contract type and operating segment:

	Three Months Ended March 31,	
	2018	2017
	(Amounts in millions)	
<u>Data and Analytics Services Segment</u>		
Time-and-material Contracts	\$ 5.6	\$
Fixed-price Contracts	1.0	
Subtotal Data and Analytics Services	\$ 6.6	\$