RCM Technologies, Inc.

First Quarter Earnings

May 10, 2023

CORPORATE PARTICIPANTS

Kevin Miller, *Chief Financial Officer, Secretary and Treasurer*

Bradley Vizi, *Executive Chairman and President*

CONFERENCE CALL PARTICIPANTS

Alex Rygiel, *B. Riley Financial*

William Sutherland, *The Benchmark Company*

Frank Kelly, *Private Investor*

PRESENTATION

Kevin Miller

Good morning and thank you for joining us. This is Kevin Miller, Chief Financial Officer of RCM Technologies. I am joined today by Brad Vizi, RCM's Executive Chairman.

Our presentation in this call will contain forward-looking statements. The information contained in the forward-looking statements is based on our beliefs, estimates, assumptions, and information currently available to us, and these matters may materially change in the future. Many of these beliefs, estimates, and assumptions are subject to rapid changes. For more information on our forward-looking statements and the risks, uncertainties, and other factors to which they are subject, please see the periodic reports on Forms 10-K, 10-Q, and 8-K that we file with the SEC, as well as our press releases that we issue from time to time.

I will now turn the call over to Brad Vizi, Executive Chairman, to provide an overview of RCM's operating performance during the quarter.

Bradley Vizi

Thanks, Kevin. Good morning everyone.

As discussed in March, after finishing 2022 strong, RCM started 2023 slower than expected, with a sequential decline in run rate primarily due to project timing and program wrap-up in our Engineering segment. But as anticipated, the cadence of activity increased as we move through the year, allowing us to retain our offensive posture as we continue to build on the foundation carefully laid in each of our business units.

Also, despite the steady drumbeat of companies shedding staff, RCM continues to hire. In my experience, the best time to invest is when others pull back, fortifying our greatest asset, our workforce. If anything, we believe wholesale restricting in certain parts of the economy's labor force should provide further secular tailwind to our business model.

In addition, increasing employee turnover, technological dynamism, and perennial macroeconomic uncertainty further incentivized companies to focus on what they do best and embrace us as a value-added partner with decades of experience in human capital management.

Now I will briefly provide an update on each business unit, starting with healthcare.

Our Specialty Health Care division had a solid first quarter, exceeding our fourth quarter performance and demonstrating sequential growth. The increased demand for nurses, allied health and behavioral health professionals significantly contributed to our success. Our dedication to delivering best-in-class healthcare staffing solutions to our clients has been the primary driver of our results. We have attracted new hospital and K-12 school clients, and our existing clients have increased their essential workforce, further fueling growth.

In addition, we have a robust pipeline of new school districts across the United States. This expansion presents significant growth opportunities and we are excited about its potential. Our focus on providing highly skilled and experienced healthcare professionals to school districts will drive our success in this growing market.

The current nursing and behavioral health professional shortages in schools have become a significant concern for educators and healthcare providers. The post pandemic environment has further stressed a system already facing decades of underinvestment. This shortage of healthcare professionals impacts the students' health and wellbeing. It poses a significant challenge for educators and healthcare providers responsible for ensuring they receive the best care and education.

The need for nurses in schools has become even more critical. Nurses play a vital role in educating and promoting health among students. Additionally, the need for more behavioral health professionals in schools has become a significant challenge for educators. The lack of mental health resources makes it difficult for schools to provide students with the necessary support to cope with behavioral health issues.

At RCM, we understand the importance of collaboration with our clients to address these shortages and support students. We are committed to working closely with our K through 12 partners to find innovative healthcare staffing solutions and ensure students receive best-in-class care.

On the Life Sciences and IT front, our HCM practice continues to accel by expanding our managed services agreements with a large workforce management technology provider. The program has been so successful that we have become the largest partner for one of its core offerings and expanded our partnership into the client's second flagship offering. Collectively, the two programs bolster our multi-year managed service portfolio.

Our Life Sciences team has secured several new clients, including two large-scale manufacturing commercialization projects. In addition, our shift to long-term managed service contracts has largely mitigated our exposure to business volatility.

We see increased opportunities for 2023 as we expand our services and reach across all our primary service offerings. The shift in focus away from one-off episodic engagements to long-term offerings has provided a platform for growth in all economic conditions.

Moving to Engineering, first quarter RCM Process and Industrial results were modestly above plan, with strong growth in backlog and pipeline. A high level of start-up and commissioning work at our job sites and the timing of new customer projects led to performance below the Q4 run rate. However, this strong uptick in bookings at the end of the quarter demonstrates delivery to the forecast and a trajectory for year-over-year growth.

Growth is forecast to continue as additional projects become fully funded and current demonstration scale work fuel multiple production scale ventures. The potential of the Process and Industrial group, and most notably, the Thermokinetics business unit, continues to flourish with diversification in customers and markets evidenced by backlog and recent awards.

RCM Thermal Kinetics has gained momentum with several new clients and strategic partnerships, including Solugen, a global leader in scalable synthetic biology, bringing sustainability and nontoxic ingredients to the chemicals industry. You can read more about their work in the March edition of *Manufacturing Today* magazine where Solugen is featured in a major editorial. New partnerships like this complement longstanding ones with companies like Fluid Quip Technologies where we have brought another two fuel ethanol projects online in Q1, both in Brazil.

As the push for a carbon-neutral future and increased demand for materials drives investment for facility owners, RCM Thermal Kinetics is also seeing an increase in demand for equipment in the aluminum rolling mill industry. Our technology provides a high-value solution for recovering expensive rolling oils through a distillation process and supports plant operators in meeting environmental compliance while reducing costs. This is another example of diversification in customers and end markets our technology-led business model serves.

Energy Services continues to build growth and momentum through the first quarter. The team kicked off several projects with one of North America's largest utilities mid-quarter, and is seeing the backlog and pipeline grow substantially for this work well beyond 2023, with multiple seven-figure PL awards secured during the quarter.

The Energy Services group continues to grow its footprint and is pleased to announce the opening of its new office in Germany. This achievement is well aligned with the group's mission to be a trusted partner as we grow our footprint to better align with the expansion of these key relationships.

We were awarded a substantial project for a large European utility client during the quarter. We look forward to strengthening its ability to support the modernization of the grid and partnering toward a carbon-neutral future for energy across Europe.

The Energy Services group has one of the most robust portfolios of clients and backlog in its history. It remains focused on building upon this sturdy foundation to deliver efficient, quality-focused, innovative solutions for our clients' success.

Aerospace continued to drive growth through the first quarter of 2023 by adding customers and expanding scope with existing clients, while adding new capabilities and seasoned executive management to complement existing team. We have added three new customers to our portfolio and broken into the aerospace component and engine market, presenting huge potential. Our new senior management team provides much needed experience and expertise in the manufacturing realm of this environment.

Our employee base in this space air mobility arenas continues to expand into other adjacent areas in engineering and aftermarket with both new and current customers.

Our sales pipeline is the largest it has ever been with potential to close on five to seven new clients and opportunities before year-end 2023, gaining us a foothold in many of the largest and most successful OEMs in the industry. The depth and breadth of this new development will include new air mobility clients, vertical flight, sea vessels and commercial airlines.

Our recruitment team remains ready to compete and utilize its network agility and speed-to-market approach, which has proven successful with several recent ramp rate requirements at clients.

Additionally, we added a Senior Vice President, Aftermarket with experience in negotiating maintenance agreements, leading cross-functional teams and surplus parts strategies, and establishing partnership agreements in new market segments. This addition will help drive diversification into other areas of aftermarket. The aftermarket segment continues to be an area of growth throughout the industry.

Attending Aviation Week MRO Americas in April, we learned that demand for air traffic remains strong while skilled labor and parts shortages continue to be challenging. This combination is ideal for RCM's Aftermarket solution as evident in our many discussions with OEMs and MROs.

Before turning the call to Kevin who will cover our financial results in more detail, I will take a moment to touch on our progress on the capital allocation front.

Since the start of the year our clean balance sheet and high cash generating business model have allowed us to repurchase over 1.2 million shares, including purchasing 334,000 shares in an opportunistic private transaction. In addition, as we work through our seasonally strongest cash generating quarter, we maintain great financial flexibility to pursue growth programs and react opportunistically to capitalize on market anxiety.

Now, I will turn the call to Kevin to discuss the Q1 2023 full year financial results in more detail.

Kevin Miller

Thank you, Brad.

Regarding our consolidated results, revenue for the first quarter was $67.2 million. The decrease in revenue was mainly due to the following. In Health Care we have a comp against our peak COVID impact in Q1 of 2022, so naturally we saw a decline in revenue as the pandemic shifted to an endemic. However, as telegraphed in our last call, we saw solid sequential growth as the underlying non-COVID related demand for our services is robust.

As for Engineering, Q1 '23 was a quarter we occasionally see where there is a gap from several large projects ending around the same time and not getting immediately replaced with new projects. We expect our Engineering group to see sequential increases throughout the rest of 2023.

Gross margin in the first quarter was 28.3% versus 28.6%. We saw outstanding gross margin performance from Health Care and Life Sciences & IT. However, we saw weak margin performance in our Engineering due to lower utilization associated with project gaps.

As we look to the second quarter, we expect Health Care to continue to experience its underlying sequential growth trend; however, due to school closings we expect to see a sequential top line decline. Our second largest school client closes at the end of May and most other school clients are not in session through June

30. We are optimistic that our Engineering group can match whatever sequential decline we see from Health Care. As for IT, we expect to see a modest sequential increase in the second quarter.

As we look beyond the second quarter, we expect our Health Care group to continue to see strong growth trends. As we get through summer school closings in QA3, we believe that Q4 2023 will be Health Care's best quarter in 2023 by a significant amount. In addition, we are incredibly excited about new schools and our behavioral health offering for the 2023/2024 school year.

We expect to continue to see significant sequential gains in our Engineering group as we realize our strong project backlog and continue to convert the pipeline.

With recent managed service wins in Life Sciences & IT, we anticipate sequential growth each quarter in 2023.

In summary, we believe we are lining up an impressive fourth quarter and run rate as we head into Fiscal 2024.

This concludes our prepared remarks. At this time, we will open the call for questions.

Operator

(Operator instructions).

It does look like we've got at least one question in so far from Alex Rygiel from B. Riley Financial. Your line is now open.

Alex Rygiel

Thank you, Kevin, and thanks for the added guidance there. As it related to your comment about Specialty Health sequentially being down a little bit, it sounded like you suggested that 2Q sequential down would be basically offset by the Engineering team, so I wanted to confirm that first. .

Kevin Miller

I mean, sure. Obviously, we don't know what the exact revenues are going to be in Q2, but like I said we're optimistic that the two will offset each other.

Alex Rygiel

Great. Then, Brad, bigger picture, very bullish comments from a macro standpoint. Your capital allocation and your share repurchases in the first quarter would suggest your confidence kind of heading out. You referenced a number of new customers and it sounds like therefore backlog is growing. I know you don't disclose backlog but can you help us to sort of understand maybe how backlog has changed year-over-year or sequentially, and how you see that growing throughout the year?

Bradley Vizi

Backlog is certainly building. But what's probably more encouraging is pipeline activity and the level of confidence that we have. Not only is it broadening across the portfolio but the size of the work and the level of involvement with our clients is also increasing. So, again, as we continue—as the business continues to mature and we have increased confidence in cadence, we're certainly willing to share that.

Inevitably, given the project orientation of some of what we do when you start to get into the kind of precise guidance, it becomes a little bit more difficult, particularly when you're balancing growth versus profitability.

Alex Rygiel

Very helpful. Thank you very much.

Operator

With that, there are no further—we just got another question. Bill Sutherland of Benchmark, your line is now open.

William Sutherland

Thanks. Hey guys, so as you try to think about the timing of the projects coming on in Engineering, does it feel like it's going to be not just a back-half weighted year but maybe even more in the fourth quarter, or will it be more evenly distributed?

Bradley Vizi

Hard to say exactly, Bill, because some of the timing of the projects is difficult to project. But I think that we'll see Q3 should be significantly better than Q2, and Q2 should be significantly better than Q1, and I think Q4 will be better than Q3. So I think we're going to—I think both Q3 and Q4 should be strong, as we sit here today and forecast the backlog rollout and the realization of pipeline, but Q4 should be better than Q3 as well.

We're optimistic we'll see a nice little increase each quarter as we head out.

William Sutherland

You typically get a seasonal—Q1 is seasonally off at least a little bit from Q4 just because of the projects that get wrapped up and you have to start new ones?

Bradley Vizi

Typically yes, every year is a little different, but we often see that.

One of the things that impacted us in the Q1, in addition to some major projects ending, is one of our major aerospace clients lost a contract and we had about 30 people come off billing. Which is fine, these types of things happen. When you're in the business of filling gaps for clients, you're going to wind up with some gaps yourself, but we're seeing that rebuild and we think the second half for aerospace is going to be dynamite.

Brad mentioned that we have a whole bunch of new clients that we've never worked with in the past that we think we're going to close. We've added several new clients in the beginning of this year. They'll take a little while to ramp and then we have five to seven more that we think we could close between now and the end of the year. So, we're really, really excited about what we have going on in the aerospace group. Despite not showing up in the Q1 numbers.

William Sutherland

Then when you look at the clients that you're onboarding (inaudible) in the fall, this coming school year, do these tend to have contracts that kind of start September 1-ish, or do you have some that are a little off the traditional education calendar? Just curious as far as that.

Bradley Vizi

The contracts are a kind of bit all over the map, but a lot of the newer contracts that we're getting are general MSAs, right? If you win an MSA with a school client in April, you may or may not be able to place some people with that client at the end of the current school year. Sometimes we can add a few people. Sometimes you win a contract and it's, "Okay, we're gearing up for September of 2023." But we're optimistic that when the new school year rolls around—and some of our clients start in August, some of them start in September, we're really optimistic about a lot of the new contracts—either contracts that are new and we're not—we don't have a lot of providers there, or contracts potentially that we could win between now and the 2023/2024 school year because we're talking to a whole bunch of schools that we feel good that we can close, but sometime over the summer so that we can get some people in there in September.

Then you've got school contracts that we won for 2022/23, you don't always go in there and put 30 people in. The first year you might put in 10, and then the next year maybe you get up to 30, and the next year maybe you get up to 40 or 50 if the school is big enough to support that many people.

So it's really kind of all over the map. But I think the bottom line is we're very optimistic about when we look at the new schools that we've added and the pipeline schools that we haven't added yet that we think we can add, we're really excited about '23/24, and we won't see that impact until September, end of August. That's the main reason when we talk about Health Care having a great Q4, that's why. We think we're going to have a really good Q4 for Health Care.

William Sutherland

Got it. Then, Brad, on capital allocation, you guys have repurchased 1.2 million shares through the end of 1Q, or …

Bradley Vizi

No, through today.

William Sutherland

Through today. Okay.

Bradley Vizi

Through today, right. So, if you want, I know you always like to get our share count. I'd be happy to give it to you.

William Sutherland

Yes. Absolutely.

Bradley Vizi

Our share count as of today—and this is without dilutive shares—is 8,269,332. That's our share count as of today without dilutive shares. The dilutive shares in Q1 were about 229,000 shares.

William Sutherland

Wait, you …

Bradley Vizi

Let me just, so you're not confused. As of today our share count without dilutive shares is 8,269,332, but I'll give you the Q1 as well because I know you like to get those. So that there's no confusion here. Hold on. Let me just flip to the Q, which I expect to file at the end of today, to our footnote here.

Our share—our diluted average share count for Q1 was 9,401,867.

William Sutherland

Got it. Okay.

Bradley Vizi

All right. And that includes 229,356 of dilutive shares for Q1.

William Sutherland

Oh, I understand what you're—okay. Now I understand what you are saying.

Then you're just—it's kind of an opportunistic posture. The authorization is how big at this point?

Bradley Vizi

As of today, $23.5 million we have left for potential purchases.

Kevin Miller

Yes. I think the one thing I would add to that, Bill, is, look, we're not capital constrained whatsoever, and we have a high level of confidence in the business that we're building here and the teams that we brought on and have filled out or increasingly enhancing and the activity that they are generating.

So, we obviously have done a good job converting cash flow over the last few years. We anticipate to continue to generate significant amounts of free cash flow. We actively evaluate bolt-on opportunities that we feel like we can grow materially as part of the RCM platform. So, with kind of the stock trading at the current levels, it's—the decision tree is relatively straightforward.

What we like to do in terms of capital and the high return projects we like to target, they're not mutually exclusive. It's kind of the ones that make sense we'll move forward. We have plenty of capacity to deploy capital where it makes sense.

William Sutherland

Got it. Okay. Thanks guys, appreciate the color.

Operator

All right. Next up, it looks like we have Frank Kelly, a private investor, now on the line

Frank Kelly

Gentlemen, good morning. How are you, Brad? How are you, Kevin?.

Bradley Vizi

Good.

Kevin Miller

Hi Frank.

Frank Kelly

Great. I was looking at AR. Our DSOs are considerably up year-over-year. I think they've got to be pretty incredible. Then I turned around and I looked at interest expense on our line. Would it be—what do we have to say about that? It looks like it's $9 million in increased line that we've used. We could save $0.5 million in interest versus collecting that cash. What do you guys think on the DSO and what's happening there?

Bradley Vizi

Sure. The DSOs are definitely up in Q1 and certainly above a level that we've been accustomed to for the last two years. As you know, Frank, they can fluctuate for all kinds of reasons. We often see a spike in Q1, just because I think we usually see a lot of our clients pushed to get cash out the door at the end of a calendar year and then sometimes they take a little pause in the first quarter. So it's not unusual to see a spike in the first quarter.

But I would tell you that frankly they are a lot higher in Q1 than I'd like to see them. And I think they are higher than what we expect to see going forward.

I think if we look at the last year, our DSOs are quite good, but the Q1 of 2023, they were not good and we expect them to come down.

Frank Kelly

Great.

Bradley Vizi

As far as the interest is concerned, obviously the—obviously a decline in DSOs will—assuming no big increase in revenue, will help us to decrease our debt and that would obviously help decrease our interest expense.

But, you know, the main driver of the debt is obviously the repurchase program, which we'll take that trade-off in share count versus a little bit of a bump in interest expense all day long in terms of the EPS and having a leverage ratio that makes sense.

Kevin Miller

Frank, just to put a fine point on the interest expenses. Under any sort of reasonable assumptions, we don't see kind of after-tax interest expense being much more than a million dollars. We don't anticipate significant leverage relative to our earnings power or anything like that. We have a great relationship with our bank, so—but your point is well taken. It wasn't our best collections quarter. The finance team is on it. We anticipate good free cash flow in Q2 as we would have seasonally anyway. But there's also opportunity to improve DSOs from where we're at.

Bradley Vizi

For sure.

Frank Kelly

Great. Great, great. I'm sure you guys are on it.

The other question, could you shed some light on the gain of sale of assets, which was kind of a one-off extra 400 grand this quarter. What was that related to?

Bradley Vizi

As I'm sure you're aware, we sold our Canada Power Systems group in 2021 and there was some escrow funds associated with that. The accounting on that is you don't recognize the gain until the cash comes in.

Frank Kelly

Got you.

Bradley Vizi

That was just a matter of us collecting the last amount of escrow funds. It was like a one-third, two-thirds collection. We collected some last year, which is what—I think it was in the fourth quarter or the third quarter it was recognized maybe. That was a smaller amount because that was a portion of the escrow. Then the balance of it was paid up this year and there's no more funds. That deal is done and the escrow has been returned to us.

Frank Kelly

Great, great. Yes, it's just the extension on that was out two years, right?

Bradley Vizi

Eighteen months, Frank, which was—which, frankly, was a rough negotiation but we got it in 18 months.

Frank Kelly

Great, great.

Last question on the capital allocation. The program that the company is currently pursuing, do we see that continue throughout the rest of, the remainder of 2023?

Kevin Miller

Yes. Certainly through the remainder of 2023. We continue to be openminded. Look, as the business continues to strengthen, we continue to grow EBITDA, right, and share count is lower, I mean that just further opens up the field.

Like I said, we're not ruling anything out. Like I said, I don't think that it's fair to anticipate any type of a distribution or a dividend this year, but going forward we're not completely opposed to it. It's something that we do talk about.

Frank Kelly

Great, great. I appreciate it. Keep up the good work. Look forward to the next Q.

Bradley Vizi

Thanks, Frank.

Operator

With that, gentlemen, we no longer have any questions in queue, so I can remind participants if they have any last minute questions, please press star, one, on your telephone keypad.

At this time I'm seeing no further questions in queue.

Bradley Vizi

Thanks everyone.

Kevin Miller

Thank you everyone for your time today. We look forward to our next update in August.

Operator

All right. Ladies and gentlemen, that does conclude your call. You may now disconnect your lines and thank you again for joining us today.