RCM Technologies, Inc.

Year End 2023 Earnings Call

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CORPORATE PARTICIPANTS

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

Brad Vizi, *Executive Chairman and President*

CONFERENCE CALL PARTICIPANTS

Alex Rygiel, *B. Riley Financial*

Bill Sutherland, *The Benchmark Company*

William Duberstein, *Stone Oak Capital*

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 filed with the SEC, as well as our press releases that we issue from time-to-time.

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

Brad Vizi

Thanks, Kevin. Good morning, everyone.

We finished 2023 at the high end of expectation. More important, we believe the fourth quarter demonstrates a COVID-free picture of our progress and traction against our Smart Growth strategy with all three businesses generating healthy EBITDA growth. Our platform of high value capabilities in critical end markets clearly resonates. Our ability to leverage points of collaboration amongst groups continues to gain traction. Whether providing facilities and solutions for a key client in aerospace or delivering technical solutions to the K through 12 market, the synergy of the platform continues to grow as we provide increasing value to our world-class client base, further differentiating ourselves in the marketplace.

Since we last spoke, progress has been made across each of our divisions, and I am excited to discuss in more detail starting with healthcare.

As many of you are aware, we take considerable pride in our leadership in the K through 12 end market. One of our key strategic focuses is to leverage that leadership to expand our K through 12 client base.

In healthcare, caring is paramount, and given our commitment to the nation's most precious assets, we believe RCM has developed an intangible asset of its own that will afford us expanding opportunity to do what we do best.

In addition to building our esteemed roster of clients nationwide, the success of our approach is evident as we effectively convert low revenue new schools into greater economic opportunities. This progression is a testament to our high-performance standards and the delivery of exceptional care to students.

Regarding overall business performance, we are delighted to report growth across all business units. This comprehensive expansion underscores the resilience and adaptability of our business model. We are particularly excited about the robust pipeline of opportunities, indicating a promising trajectory for the healthcare group.

As we move through the upcoming year, we remain steadfast in our commitment into innovation, client satisfaction and sustainable growth. We are confident that our strategic initiatives will contribute to the continued success of the healthcare division.

Now moving to Life Sciences, Data and Solutions.

The results of 2023 demonstrate the economic horsepower of our team's strategy and revolves around value and solution selling. This can be seen from improvement in every financial measure: revenue, GP, GP percent, NOI, and NOI percent.

GP percent improved by 430 basis points, while EBITDA contribution improved over 375 basis points. Nearly 70 cents of every dollar of revenue increased from 2022 to 2023 converted to EBITDA. Managed service and turnkey software implementations led our growth. I take tremendous pride in this group's clear commitment to operational excellence.

As we look forward toward 2024, we continue to see strong growth led by Life Sciences through our managed service commercialization, data integrity and quality improvement programs. Continued strength in our HCM practice will further drive results.

Twenty twenty three was a year of strong performance from Energy Services. Revenue and profit targets were achieved, exceeding the previous year's profit contribution by 66%. Energy Services successfully executed grid modernization substation projects for large utilities and OEMs in North America and Europe.

These projects include engineering services for a large-scale infrastructure project in the New York area that will be a critical interconnection point for delivering increasingly renewable power from offshore wind parks.

In 2023, Energy Services opened an office in Germany to expand its global footprint and become a preferred partner for the energy transition in Europe. Within the first year of its German operation, Energy Services was awarded two EPC projects from one of the most innovative German transmission system operators. This TSO sent a delegation to the U.S. to visit several projects Energy Services had successfully executed. The trip was concluded with the award of the second project between our two firms and commitment toward a long-term partnership.

Also of note, Energy Services further developed its technical capabilities to offer our own proprietary digital solution for 3D BIM and digital data management applications to support utilities and enhancing their efficiencies from planning to construction and operation. The monetization of our application is a major step in our productization effort, consistent with our strategy to position ourselves as thought leaders and strategic partners with clients, broadening our competitive mote and delivering more value to client partnerships.

RCM Thermal Kinetics has several active equipment and engineering contracts for projects in zero carbon chemical manufacturing, carbon capture and sustainable (inaudible) markets. The projects employ a variety of technologies designed by the engineering team, including distillation, evaporation and crystallization technologies. These contracts are with dynamic customers who are growing as established leaders in their respective markets and have standardized on RCM Thermal Kinetics process, design and equipment supply.

The new RCM Thermal Kinetics testing lab has been fully utilized in 2024 due to customer test project support and product profiling related to new equipment proposal development. The test lab has added a new glass crystallization system and has fully commissioned the unit. This unit is also being used to support active crystallizer projects. Future expansion plans include a 30-gallon crystallization pilot plan. Engineering for the pilot plant crystallizer is scheduled for completion at the end of Q1.

The Aerospace and Defense group experienced a steady recovery in Q4 2023. Though we did add clients and headcount during the quarter, it’s worth noting that our clients' outlook is more focused on 2024. Regardless, we did recognize the receipt of additional workload with existing clients and new clients to expand our model-based expertise, digital conversion, software and systems employee base in 2024.

Aerospace and Defense has now become a trusted provider of a new service offering—involving rectifying quality and production issues within the supply base of our clients. Our approach and solution has been modeled from within our Management Team informed by decades of industry knowledge and background they possess (inaudible). Since the supply base for many OEMs has experienced issues globally, such as part shortages and material availability, we are in the process of deploying teams to help solve these challenges and have received interest across multiple OEMs.

We continue to expand our teams within our workforce solutions software systems in highly technical areas, especially in the air mobility sector, which has become a draw for many candidates.

I will turn the call to Kevin to discuss the Q4 2023 financial results in more detail.

Kevin Miller

Thank you, Brad.

Regarding our consolidated results, consolidated gross profit for the fourth quarter grew by 5.7% from $20.5 million to $21.6 million. Adjusted EBITDA for the fourth quarter grew by 18.5% from $7.5 million to $8.9 million. Adjusted diluted EPS grew by 37.5% from 52 cents to 71 cents. As for segment performance in the fourth quarter of 2023, healthcare gross profit was essentially flat. If we remove the impact of COVID on the consolidated revenue and compared to the fourth quarter in 2022, we estimate that 2023 gross profit grew by 4.4%. However, our school revenue after normalizing for COVID, grew by over 28% Q4 to Q4.
Life Sciences, Data and Solutions gross profit grew by 19% in Q4 '23 compared to Q4 '22. Largely behind the Energy Services group, engineering gross profit grew by 8.6% in Q4 '23 compared to Q4 '22. As for fiscal 2024, we anticipate that we will see at least low double digit consolidated Adjusted EBITDA growth as compared to fiscal 2023, with a similar quarterly cadence when compared to fiscal 2023.

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

Operator

If you have a question, please press *1 on your telephone.

Our first question is going to come from Alex Rygiel with B. Riley. Your line is open.

Alex Rygiel

Thank you. Good morning gentlemen and nice quarter and nice year.

Brad Vizi

Thank you.

Alex Rygiel

First, if we could touch on the balance sheet a little bit. Obviously, DSO spiked a little bit. There's a lot of seasonality that occurs to probably some majority of that. Can you talk about that increase and possibly the working capital improvements that you see coming in 2024?

Kevin Miller

Sure, be happy to speak about that. We ended the quarter with a little over 90 DSOs, 90.7, which is similar to Q3, which was 90.1; both of which, frankly, Alex, are just much too high in terms of where we expect to be and where we believe we will be in the future. The thing that we see often with the schools is that they always pay, but sometimes we run into administrative issues that cause a bit of a blockage in terms of getting paid, right, and then all of a sudden, we get four or five months all at once. Now most of them pay regularly but every once in a while, we run into issues.

Our second largest client and second largest healthcare client basically for administrative purposes did not pay us from July through December and we had about a $15 million balance at the end of the year. I expect that to be under $8 million by the end of this quarter, and most of that money has already come in. It may even be a little bit lower; we'll see. So we think we've got that client back on track. They had a great record of paying us pretty timely over the last three or four years.

So, really, in terms of the receivables at the end of the year, just putting that one problem aside, that should be $53 million, $62 million, and frankly, there's a few other things that we need to work on. The WIP is a little bit high. That tends to be kind of cyclical depending on wherever you are with projects. We have a couple of newer healthcare clients that we're still getting the rhythm within terms of POs and getting everything approved and blah, blah, blah. But we believe the 70 million is too high. It's temporary and we're going to get it down.

I think the way that you should think about it, frankly, is we should have DSOs below 75. Ideally, in the low 70s, but it certainly should be below 75 and we won't get it—probably get it to that level at the end of Q1, but will be much lower at the end of Q1, and over the next couple of quarters we will get the DSOs down to a more acceptable level or in the low 70s.

Alex Rygiel

That's very helpful. And then, Brad, maybe you could talk a little bit about sort of the growth outlook by segment in 2024.

Brad Vizi

Yes. Look, we expect all three of our segments to grow. You know, spent a lot of time doing strategic planning here in the last 90 to 120 days and, frankly, it's very encouraging. Pipelines are very strong and backlogs are stronger than they were last year. That being said, we're constantly balancing growth with investment. So, growth and profitability today, productive revenue with investment in the future. So, on a consolidated basis, we're comfortable where we sit today with the guidance we put forward, but underneath the surface, we anticipate all three segments growing as well.

Alex Rygiel

And then lastly, you've been very aggressive with your buyback through the years, strategically buying stock on opportunistic dips. The market appears to be giving you one of those right now. Can you talk about your view on repurchases right now and what your authorization stands at?

Brad Vizi

Yes, no, we certainly have authorization and there's a good chance it's going to be increasing in the near future. But with respect to overall capital allocation, and you look at our share count, we have less than 8 million shares outstanding. So, we're in a high-class position where you think about that incremental share you buy, right, that trade off of liquidity, because we certainly want to balance having a liquid tradable stock for our investors to enter and certainly have the option to sell at some point in the future with, frankly, taking in what we view is an investment opportunity at a steep discount to intrinsic value.

So, buybacks are always part of our capital allocation framework. If we're in a position to be opportunistic, and we're going to do that. It's being mindful with each incremental share certainly detracts from the float and the liquidity. But by no means are they off the table. They're firmly on the table.

Alex Rygiel

Very helpful. Thank you. Good luck.

Operator

Our next question is going to come from Bill Sutherland with Benchmark. Your line is open .

Brad Vizi

Hey, Bill.

Bill Sutherland

Thanks. Hey guys, good morning. The gross margin performance was very steady year-over-year, and you saw a nice pickup in the Life Science gross margin. Are you kind of at a steady state level as you look forward into '24 or are you expecting some improvement in any of the segments?

Kevin Miller
I would say it's probably steady state. You'll see some gyrations from quarter to quarter, obviously, especially in engineering when we do have some—when projects stops and starts and bench (phon) and whatnot, but I think we're steady state. Typically, we do see an increase in payroll taxes of somewhere between $1 million and $1.5 million when you go from Q4 to Q1, so that obviously impacts gross margin and net margin. But that's just a seasonal thing, right. But yes, we like where the margins are and we think we can maintain those or at least close to that.

Bill Sutherland

Great. On healthcare, Kevin, do you have the breakdown between education and (inaudible)?

Kevin Miller

I sure do, because I knew you were going to ask for it. Let's see. Education was—school revenue in Q4 was $29,812,000, and our non-school was $6,876,000.

Bill Sutherland

Okay. Do you have the comp just in case I don't even—I just want to make sure I know that.

Kevin Miller

Yes. The comp quarter to quarter, school revenue in 2022 Q4 was $24,644,000 and non-school was $11,166,000.

Bill Sutherland

So that non-school, which includes HIM (phon), I know it's—is that kind of a run rate now that it's been steady or even…

Kevin Miller

Yes, no, you can definitely look at that as a steady run rate. I mean, we expect that to grow from there. When you look at Q4 '22, we had quite a bit of COVID revenue in there and we also had a very big client that we scaled back a little bit just because frankly we don't like the way that they pay. So we scaled back the number of people that were willing to stretch out payment on. Good client that always pays, but we can only allocate so many dollars to high (inaudible) clients.

Bill Sutherland

Right.

Kevin Miller

But we've got some pretty interesting things that we're working on to outside of the schools that we think can drive that a bit higher.

Bill Sutherland

And then the last one…

Kevin Miller

Putting in HIM, which is one of the ones that you mentioned.

Bill Sutherland

Yes. In capital deployment, just to look at that again, Brad. Are you guys—how are you thinking about where you are with debt and how you might think about the deployment for share repurchase versus maybe reducing leverage?

Brad Vizi

Yes. We've been pretty consistent with our framework. We still are less than one turn of EBITDA of leverage, which is a pretty efficient capital structure, and we certainly have the ability to flex up from there and significantly from a capacity perspective, but from a financial framework perspective, we have ample dry powder to do what we'd like to from a capital deployment perspective. In terms of potentially deleveraging and taking the balance sheet to a net cash position, some time over the next 12 months or so, we're potentially taking in more shares. Again, having less than 8 million shares outstanding I think that gives us the opportunity to really be thoughtful and looked at a lot of different options.

So, would we be happy to take it to 6? Absolutely. But somewhere around 8 million, there's a trade off associated with it that we just are mindful of.

Bill Sutherland

Actually, let me tack on one more off the deployment picture. Are you all—how would you characterize your M&A activity as far as looking at opportunities these days?

Brad Vizi

Yes. We're always looking. Primarily bolt-ons, we're very interested in capabilities, both on acquisitions that we think we can grow and add significant value to. The reality is I think the platform that we have, we've built over the years, I think is pretty unique to the marketplace, and we think we can leverage our existing client base relationships and our teams to add a lot of value to capabilities that we view are unique and scalable.

So, always looking, very, very selective and obviously culture is a key component of that.

Bill Sutherland

Brad, do you guys kind of weigh—kind of look at the segments equally as far as opportunities or are you more—emphasis on one or two of them?

Brad Vizi

I'd say we look at them equally.

Bill Sutherland

Okay. All right. Thanks guys. Appreciate the color.

Operator

Our next question is going to come from William Duberstein with Stone Oak. Your line is open.

William Duberstein

Hey guys. Great to be on the call. Thanks for having me on, and really nice performance. I have a couple but first one housekeeping on the share count. I think you said you had a little under—you had like 7.8 million shares outstanding. On the income statement, you put forward the diluted share count was closer to 8.1. I was just wondering if that was, Brad, your kind of long term incentive awards being included or what the discrepancy was there?

Kevin Miller

Yes, no, those are the common stock equivalents, Bill. So when you have outstanding equity grants, those are computed into the diluted share count, right. So, when Brad was giving his share count, he's talking about the shares that are actually outstanding as of today, which is under $8 million.

William Duberstein

Got it. Perfect. Thanks. Now on to some operational stuff. Just curious, the engineering, the topline, was a little bit down year-over-year but gross margin improved a lot, which is probably the most relevant metric. I know you had kind of the loss of that one contract early last year and that you expected that aerospace segment to kind of improve through the year. I was just wondering if you consider it recovered, and then sort of the different puts and takes between aerospace and engineering with the TransnetBW, if that's playing a factor. And then industrial, if you could just kind of dig in more granularly to the engineering segment.

Kevin Miller

Yes. So before Brad speaks on this, just to correct you a little bit on one of these. We didn't lose a big contract. We had a big contract get reduced by about 30%, which was obviously a blow, but we didn't actually lose the contract. We still have it, the contract that we spoke about on our earlier call. I'm sure Brad would love to talk about expectations in terms of revenue going forward.

Brad Vizi

Yes, further granularity on that point. We didn't lose share on the account, it was more a major end client. Lost the program or wasn't awarded a program that we anticipated and had some headcount reduction associated with that, just to clarify. With respect to the prospects for margin in engineering, and I should think there's upside and, you know, when you look at it for the year and going into the future, and that's primarily going to come from aerospace. I think the other two businesses have room for improvement, certainly, but in aerospace there's primarily been a staffing orientation that I think you're going to see slowly migrate to a richer mix of services. So, our outlook is net positive with respect to margin profile in engineering.

William Duberstein

Great. And then just one more quickly. The Life Sciences IT segment was clearly the star of 2023. I know you've been transitioning to more sort of project-based solutions rather than time plus (phon). You also had the acquisition of TalentHerder in Q4 of last year. I'm just wondering if the great performance this year, how much is organic and how much might be TalentHerder and/or if both were contributing.

Brad Vizi

Yes, a good question, Bill. We've invested heavily in that business in the last couple of years and we're going to continue to do so. Those investments are paying off, both with respect to building out the team, as well as our capabilities. The two primary drivers is really Life Sciences and HCM, and nearly all of that is organic. So there's not a lot of inorganic growth there.

I think the other thing I'd highlight with respect to that growth, not only have incremental clients that we're adding but going back to our core strategy, is really looking for strategic clients that we can both grow our core capability within. So in other words, take share within that client, provide incremental services, and so deliver more value to the client and making us more important and operating as an extension to the client, as well as, frankly, to be able to take advantage of a very strong client base that has their own growth. So, really, we have kind of three bites of the apple in that regard.

With respect to TalentHerder, the contribution—the profit contribution was de minimus, and that is in line with our previous discussion. When we did that acquisition, we had anticipated that the technology market would soften quite a bit and we've structured the deal accordingly.

So we're actually seeing green shoots with respect to the core business and profit stream and that can contribute a decent contribution in 2024, but 2023 was de minimus. I would say with respect to the synergy that it provided, that was dispersed, I'd say throughout the different segments. One of the benefits of that acquisition, there was never any core thesis around having a beachhead in technology or pushing hard into Silicon Valley. It was more the potential to benefit from really the top of the funnel their process and some of their technologies that they had. We think to some extent you're seeing that in each of the segments and you'll continue to see that grow going forward.

William Duberstein

Great. Well that's all I had. Thanks for the color and thanks very much for having me on, guys. Great job.

Kevin Miller

Thank you.

Operator

Again, if you have a question, please press *1 on your telephone.

Okay. Looks like our next question is going to come from Frank Kelly. Your line is open.

Frank Kelly

Good morning gentlemen. Good quarter, good year, and especially as well Bill have said that Life Sciences with a north of 38 GM and growing is just absolutely amazing. Just add to the topline on that and you'll be set. I think we beat the nemesis of AR up. It's been always my pet peeve. But if we look at our stock value today, there's no doubt that that's what they're reading out there. Hopefully, we've got a focus on that. Really, we saw that, mentioned by Kevin that there's some effort being put in there with a $20 million projected free flow of cash from operations in '24. I think that's conservative at best, but hopefully we can do that.

Can we—just expanding on the capital deployment, a lot of folks talk about deleveraging, which is nice, and buybacks, which is nice, but there's a risk, as Brad pointed out, to that. But one thing that wasn't talked about was shareholder return, cash shareholder return in the form of a dividend. Twenty five cents a quarter, something like that, with the number of shares that we've got outstanding. Is that on the table as well?

Brad Vizi

Probably not this year, Frank. But again, we haven't taken it off the table, and with fewer shares outstanding, when you finally get that dividend that's likely to be bigger than otherwise would be. So, appreciate your patience on that front.

Frank Kelly

Great. Great. (Inaudible). Is there a way now that we're half—well, we're in half, we're practically at the end of the first Q, maybe some flavour as to what we can expect and where we're headed for Q1?

Kevin Miller

Frank, we're hoping and planning on showing some growth each quarter over the prior quarter. So, we'll see how the quarter comes out. But we like where we are today.

Frank Kelly

Great. Great. Because I know, I guess, a call or two ago you were quite specific on some percentages, even as far as drilling down to each of the segments on anticipated percentages and things like that. Okay. So I guess, (inaudible) that, we're going to have a good Q1 or a comfortable Q1, is that I'm hearing.

Brad Vizi

Yes. I think just generally speaking, Frank, I mean, if you look at 2023, I think that's pretty indicative of the typical year as far as cadence for us. Naturally, you have summer break for schools in Q3, right. Q4 is normally our strongest quarter, and naturally, as you start the year in January and you have to (inaudible) things like snow days, reset of payroll taxes, sometimes a program will get delayed a couple of weeks, or a project or a couple of schools will open a little bit later than expected, but you see an acceleration for the quarter and ultimately through the year and until the schools start to taper off in the second half of June.

So, we don't see anything different from cadence.

Frank Kelly

Great. Thanks gentlemen.

Operator

Okay. It doesn't seem like there are any more questions in queue. I'll turn it back over for any closing remarks.

Kevin Miller

Thank you for attending RCM's fourth quarter conference call. We look forward to our next update in May.

Operator

This concludes your call. You may now disconnect.