RCM Technologies, Inc.

First Quarter 2024 Earnings Call

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C O R P O R A T E P A R T I C I P A N T S

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

Brad Vizi, *Executive Chairman and President*

C O N F E R E N C E C A L L P A R T I C I P A N T S

Bill Sutherland, *The Benchmark Company*

Alex Rygiel, *B. Riley Financial*

Ben Andrews, *Andrews Capital Management*

P R E S E N T A T I O N

Operator

Ladies and gentlemen, welcome to the RCM Technologies' First Quarter Earnings Update.

I will now turn the program over to RCM Management.

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.

Brad Vizi

Thanks, Kevin. Good morning, everyone.

As discussed in our prior call, the first quarter concluded as expected, with a seasonally slow start in January and acceleration as we moved through the quarter. Our breadth of focus is both widening and deepening throughout the organization, with all teams executing on current initiatives while seeding new initiatives to propel growth well into the future.

Further galvanizing the strength of the platform, we have introduced the shared services team, whose mandate is to help streamline the strategic focus of our groups, strengthen collaboration, and enhance communication about the RCM platform.

Throughout the month, we will launch a much-improved digital initiative highlighting the mission critical work of each of our groups and helping distinguish us as what I believe to be one of a kind platform in the marketplace.

Without further ado, I will get into updates on the progress of each of our teams starting with healthcare.

The Healthcare division started 2024 with a continued emphasis on its core. Excluding business we consider to be non-strategic, primarily consisting of a slow-paying, long-term care facility client we made the decision to reduce, Healthcare demonstrated solid double-digit top-line growth year-over-year.

As we finished lapping the bulk of this headwind in Q2, we anticipate a reacceleration of growth in the second half for healthcare. This progress is a testament to the hard work and dedication of the team.

Our K-12 education business, one of our key focus areas, continues to strengthen. We are confident about the potential of five new school districts already onboarded and 12 more in the final stages of negotiation, each anticipating to generate revenue in excess of $300,000. Also of note, there are 11 new districts toward the late stages of the sales cycle that show promising contribution in the 2024-2025 school year.

Our expansion efforts to grow our client-base nationwide continues to yield substantial results. We are leveraging our leadership position in K-12 staffing to capture new opportunities and strengthen our advantage. As we continue to execute our strategy, we are confident in our ability to deliver sustained value and growth to our shareholders.

Transitioning to life sciences and data solutions, first quarter results demonstrate a continued progress in executing against our strategy to pursue project, solution, and managed service solutions' client engagements. Our renewal business doubled year-over-year.

We have seen increased demand for our services in life sciences, HCM, and Puerto Rico solutions, and our pipeline continues to grow quarter-over-quarter. Our customers have challenged us to expand our services in HCM with the introduction of direct, white glove, and post-implementation support.

We have expanded our data management team and built a dedicated ERP solutions team. We have broadened our program practice team by introducing a robust series of organizational change management services that will enhance all of our solution practices.

As we look toward the remainder of 2024, we continue to see strong momentum in the business. Energy services closed the first quarter of 2024 with strong results, delivering double-digit forecasted revenue and EBITDA increases. Client development continues to be an area of investment for us, given the technical success of several marquee projects within the industry.

To say it differently, (inaudible) technical success is conducive to growth, and we are highly focused on leveraging our momentum in the marketplace. During Q1, energy services invested in client development in the Northeast and Midwestern United States, Puerto Rico, and Europe, building partnerships for the net zero transition and modernization of the electrical grid.

Also of note, organizational changes have strengthened the ETC and transmission line business to capitalize on increasing market demand. We believe that the foundation is set for energy services to provide a material economic contribution to RCM in 2024 and well into the future.

Within our process and industrial group, RCM Thermal Kinetics continued execution efforts for multiple equipment contracts in the zero carbon chemical manufacturing sector. The Thermal Kinetics Office has also won new engineering business in Q1 related to ethanol plant expansion and optimization studies.

The Thermal Kinetics team feels that this is a strategic area of focus as production plants try to reduce their carbon footprint and are incentivized by state and federal governments to do so. In addition, a large engineering order related to an SAF production plant was also received in Q1.

The new Thermal Kinetics testing lab was at 100% utilization through Q1 2024. Client interest in the facility continues and we anticipate utilization of the lab will continue through 2024. The team remains focused on the continuation of its emergence as a market leader in responsible and sustainable chemical process design.

The Aerospace and Defense Group had mixed results in Q1 2024 due to a lull in workload in our aftermarket segment during January and February. However, EBITDA for the division still grew year-over-year. The engineering piece of the business is thriving, executing with three new clients in Q1 2024.

There are RFIs, RFQs, and MSAs in process, most including engineering and aftermarket services with two new OEMs in vertical lift and land vehicles, three new Tier 1 manufacturers in power supplies inverters, electronics and aerospace components, and one new air mobility client throughout the Aerospace and Defense Division by the end of Q2 2024.

Our strategy to continue to drive and expand our model-based expertise, digital conversion, and software and systems expertise throughout the organization and customer base has resulted in continuing inquiries and partnership opportunities throughout the quarter.

Our new service offering, which revolves around solving quality and production issues within our clients' supply basis, continues to grow with interest and engagement throughout our client base. This expertise is also attracting new client interest. We will continue to expand our reach with these clients and prioritize these engagements in 2024.

Our project and program management additions in our engineering and aftermarket sectors are instituting welcome changes with the entire team excited and engaged. We have already seen quantifiable results from the program management office stemming from the team's exceptional efforts.

I will return the call to Kevin to discuss the Q1 2024 financial results in more detail.

Kevin Miller

Thank you, Brad.

Regarding our consolidated results, consolidated gross profit for the first quarter of 2024 grew by 7.1% as compared to 2023 from $19.0 million to $20.4 million. Adjusted EBITDA for the first quarter grew 11.1% from $6.1 million to $6.8 million. Adjusted diluted EPS for the first quarter of 2024 grew by 30.4% from $0.41 to $0.53.

As for segment performance in the first quarter of 2024, engineering gross profit grew by 27.1%, life sciences data and solutions gross profit grew by 7.9%, healthcare gross profit was down 2.4%. However, if we remove the impact of COVID from the comparable first quarter in 2023, we estimate that 2024 revenue grew by about 7.3%.

If we remove the impact of COVID and the deliberate reduction in services to a large, long-time and slow-paying long-term care facility, we estimate that 2024 grew by about 12.8%. School revenue of $31.9 million for the first quarter of 2024 grew by 19.1% after removing COVID revenue from the first quarter of 2023.

As for the remainder of fiscal 2024, we continue to anticipate that we will see at least low double-digit, consolidated Adjusted EBITDA growth as compared to fiscal 2023, with a similar quarterly cadence to EBITDA when compared to fiscal 2023. We also believe that there are significant upsides in the fourth quarter with such a robust school pipeline, starting in the 2024-2025 school year.

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

Operator

With that, ladies and gentlemen, please press star, one on your telephone keypad if you would like to ask a question. That is star, one on your telephone keypad if you would like to ask a question.

And first up, it looks like we have Bill Sutherland. Your line is now open.

Bill Sutherland

Thank you. Hello, gentlemen. Nice quarter, and very impressive in terms of some of the new business you've got lined up here. The healthcare side is—you've got five districts that are onboarded, so they will impact the 24/25 year, right, Kevin?

Kevin Miller

(Audio interference).

Bill Sutherland

Yes, I didn't—it might be my phone, didn't quite hear it.

Brad Vizi

Yes, Bill, I'll go ahead and take that one. I think Kevin might have been on mute. We're having audio difficulties here. We have five that we're highly confident on, already executed, and quite a few in the pipeline that are very much advanced. I think the figure is 11 or so that are pending execution, and roughly the same amount that we believe should get there. So I think in aggregate, something around the 30 mark that we think has quite a bit of potential.

Bill Sutherland

Brad, while you've got the mic, can you just put a little more color on the, I think you said expanding services, this is life science, expanding services in the HCM part of it?

Brad Vizi

Yes. So two of our strongest practices in that business or in that division are life sciences and HCM, as you're aware, and we've had quite a bit of success in HCM the last couple of years and been embraced by some of our clients here. And naturally when that happens, when you are successful with them with one particular need, you're at the front of the queue with respect to ancillary opportunities, right, and opportunities to build on the business that you've worked with them to build.

So it's very much along the lines of what you look for in terms of identifying strategic clients, putting our energy into them, doing well for them, and then ultimately that leading to incremental opportunities. So again, benefiting from our growth, in terms of our ability to deliver value to them as well as their growth, and that particular market is very robust.

Bill Sutherland

And in engineering, just one other one, you mentioned aerospace picking up, coming out of 1Q. Is this a sort of a slow ramp, do you think, because you did mention three new clients starting up, just trying to get a feel of the cadence for Aero this year?

Brad Vizi

Kevin, do you want to speak to cadence or do you want me to take this one?

Kevin Miller

Yes, you can try it

Brad Vizi

On the aerospace front, that group has done quite a bit of work in terms of optimizing their business mix and positioning the portfolio for the long term, basically to deliver good returns and higher margins. Making good strides on the engineering front, really solid success, as I alluded to in the compared remarks. And aftermarket, there was a bit of a lull that is picking up, particularly with some larger POs that are crystallizing this quarter, as well as new clients that started small naturally. And again, as we continue to deliver for them and gain their trust, they reward us with more work.

So when you look at the combination of those two, we have much higher expectations in the second half than what we saw in the first four months of the year.

Bill Sutherland

Just one more. Kevin, you take a victory lap here on the cash in the quarter, and you mentioned continued improvement. Is there any kind of dimension you want to put on that?

Kevin Miller

Well, quite frankly, we expect Q2 and Q3 to be better than Q1 in terms of cash flow from operations. How much better remains to be seen, but I'll be very disappointed if we don't have—when you add up Q2 and Q3, and I don't care if a lot of it comes in Q3 versus Q2 or whatever, but when you add up those two, they should be a lot more than two times Q1, and if not significantly higher, I'm going to be very disappointed with the cash flow.

Bill Sutherland

It's not just—and its not only timing. You're also just making progress in terms of some of the working capital impacts.

Kevin Miller

It's everything. It's everything. It's going to be—obviously, it starts with having a good net income, especially after considering seasonality, managing the working capital right up and down the balance sheet. Obviously, the biggest one is receivables, and we expect our receivables to be down at the end of Q2 and from where they ended at Q1 and down even further at the end of Q3. Based on what I'm seeing in the receivables right now, we're making some progress in terms of getting them to a level that is more acceptable than where they are today.

Bill Sutherland

Yes, remind us about—well, first off, what was the DSO in the quarter, and then remind us where you want to get?

Kevin Miller

Well, it's 93, long-term, I'd like to be in the low 70s. That may be a little too optimistic over the next two quarters, but we need to first get it to 85, and then get it to 80, and then get it to 75, and we're just going to keep working to get it down. Obviously, there are always factors that influence that. Sometimes we do take on high-margin clients that maybe have a little bit slower profile. Sometimes when you're working with big companies…

Bill Sutherland

Like school districts?

Kevin Miller

Well, school districts are interesting. They pay quickly, but sometimes there are just a lot of administrative hoops you need to jump through. That causes some significant fluctuations. We've seen quarters where our school DSOs are incredibly pristine, and then we've seen other quarters where they're just a little bit higher. The great thing about the schools is they pay, and they pay quickly once they approve invoices, and once the POs get all tied up in a bow and get on somebody's desk. But the schools historically pay pretty well. It's just up to us to do a little bit better job of getting through some of the administrative sort of traps that are out there. But yes, we're excited because I can see on our two largest clients that we're going to be in really, really good shape on those receivables over the next two quarters.

Bill Sutherland

Sounds good. Thanks, guys.

Operator

Okay. Next up, we have Alex Rygiel. Your line is now open. Alex, your line is now open. Perhaps you have us on mute.

Alex Rygiel

I did. I apologize for that. Brad and Kevin, nice quarter here. Quick question. As it relates to the robust school pipeline and the potential for the fourth quarter upside, when do you think you're going to have good visibility on this?

Kevin Miller

Well, it will certainly be better the next time we talk in early August. We'll have better visibility in terms of the contracts that we have in place. We'll probably have a feel for some of them in terms of what kind of revenue they're going to generate out of the chute. And then, obviously, we won't really have a feel for how much revenue all of the schools are going to generate until we get to, like, sometime until September, October. Because, you know, sometimes schools kind of surprise you in terms of when you first ramp up with them, sometimes in a good way and sometimes in a bad way.

But we've got so many new schools that we think we're going to have for next year that Brad and I are sitting here going, well, at least a few of them are going to pop and come in as pretty good clients right from day one. And then the others will work to get them to be significant clients later on in the year or '25, '26. But we've not had a pipeline like this that of new schools that I can remember, frankly, ever, in history of the Company. So it's exciting.

Alex Rygiel

And when you sign up and execute on these new contracts with the schools, can you address if there's any sort of margin headwind, maybe in the first 90 days of that new contract, or if there's a notable receivable headwind?

Kevin Miller

No, well, I certainly don't feel like there's any receivables headwind. Sometimes when we get into a new school client, every school can have, like, quirky administrative procedures in terms of getting POs approved and getting invoices approved and getting timesheets approved and IEPs approved. So sometimes when you find—when it takes a little while to get the cadence down of the administrative burdens that are at a particular school, so sometimes they're slow paying in the beginning until we sort of really work through everything that they need.

But we typically—the schools always pay. And really, there's no one school where, like, they're going to take a long time to pay. The only time they take a long time to pay is if there's some administrative stuff you need to get through. So that doesn't concern me at all. But in terms of the revenue, you just don't know for sure until you get in there and start working it. And you don't really know the gross margin until you get in there and start working it as well, but we believe that the schools that we're going to be adding should all have pretty similar margin profiles to what we have right now. And we don't see that. Sometimes you might need to put a few people in there at a little bit lower margin to really impress them and get the contract rolling. But we're not typically—right now, we're not really seeing a lot of headwinds as far as the margins are concerned for schools.

Alex Rygiel

And then more broadly across all three of your business segments. Are there any other kind of sizable contracts that are nearing conclusion or who are contemplating or have recently sort of walked away from that they're worth discussing?

Kevin Miller

Well, there is a large healthcare client that Brad mentioned, that's a long-term care facility that is mostly funded by Medicaid that just is really slow paying. We always get paid by them. They're a 20-plus year client, we've never had a write-off. But it just doesn't make sense to service them at the level that we were servicing them in 2022 and 2023, because we just don't want that much capital tied up in one client. It's not really a risk in terms of payment, but it's just a pure capital allocation decision that Brad and I decided we got to sort of slow this down a little bit. And it hurts in the short term, but it's the right decision, long-term.

But as far as major contracts, I mean, we don't really talk too much about that, because we just don't want to talk about a big contract. We think we're going to win and then not win it. But the pipeline and the backlog is strong across all the divisions. And Brad, I don't know if you want to add something to that.

Brad Vizi

Yes. Alex, to put a fine point on it, I think that there's always going to be some of our project orientation to the business, but with respect to potential headwinds of projects, basically kind of ending there's nothing really on the horizon that we're aware of that. We're don't think we're going to grow right through. Just the biggest headwind, as we mentioned, Kevin reaffirmed it was in healthcare and we think we're going to be largely through that at the end of this quarter.

Alex Rygiel

And I'm going to end with the capital allocation question here. Clearly, your cash flow outlook is very positive, balance sheet's really strong. Didn't believe you bought any shares back in the quarter, but can you talk about how you're thinking about prioritizing buybacks versus acquisitions?

Brad Vizi

Yes. Just to be clear on that, Alex, and you'll see when the Q is filed here, we bought a couple hundred thousand shares in the quarter.

Alex Rygiel

In Q2.

Brad Vizi

Yes. And look, as the cash starts to come in here over the next couple quarters, we should pretty much be delevered at that point or getting really close to it. And look, we're going to be opportunistic and we're just finding comfortable carrying around a little bit of cash for a period of time. And when the right opportunity presents itself, that means our return profile we're going to be quick to move.

That being said, we are looking at a couple of bolt-ons we were very intrigued by that we think that we can add significant value to and the chemistry is certainly right with the sellers. So, when they fit that profile with respect to a technical capability and a very attractive growing segment of the market, that we can put RAF behind in terms of sales horsepower, recruiting horsepower, right, and everything else that comes with the platform. So, we're a little closer there, but, perhaps there's more to talk about in August on one of those.

Alex Rygiel

That's great. Thank you very much. Nice quarter.

Brad Vizi

Thank you.

Operator

I'm so sorry. I was on mute there. Ladies and gentlemen, just a quick reminder, you can press star, one on your telephone keypad if you would like to ask a question. Again, that’s star, one on your telephone keypad if you would like to join the question queue.

Next up, we have Ben Andrews.

Ben Andrews

Hey, good afternoon.

Brad Vizi

Hi, Ben.

Ben Andrews

Two questions, please. When I look at the healthcare year-over-year, it looks like gross margin went down a little bit. So, the accounts that you're calling that are slow paying, they're also high margin business?

Kevin Miller

No, they're right around the normal margin. The main reason for the downturn in the margin, frankly, was we had a pretty big increase to some of our employment taxes in New York. That's sort of the biggest hit that we took in Q1. We had a pretty big increase. That will run through. And then you just have normal noise and mix shift in the margin that you're going to see. But there's nothing other than that issue in Q1 that I would say is impacting the year-over-year comparison. And keep in mind that Q1 of last year was pretty high margin compared to historic margins.

Ben Andrews

Okay. And then this might be intertwined with that question as well, but regarding accounts receivable, for a long time now, many years, it seems that you guys get it together and then it spins out of control. Then you get it together and then it spins out of control. Is that indicative of that client or is that indicative of the revenue split on the type of clients you have? Why is that?

Kevin Miller

Yes, I think that's where I can explain it, Ben, is there's just—particularly in the schools, we do run into some administrative issues from time to time, especially with our biggest clients. And we've had a lot of quarters in a row excluding the last couple where we had outstanding DSOs for those two clients. And we'll get it back to a better level. And then there's always going to be noise in terms of some of the clients that you're working with, in terms of—especially on the project side, right? Because a lot of times you can't get paid until the project's finished, there's certain milestones built in.

So there's always going to be some fluctuations in terms of the AR. I think that if you sort of looked at this Company over like a 12-year period, we don't have some of the issues that we've had in the prior years in terms of like some of the, I don't want to use the word systemic, but we had some issues where we just were not as diligent and not as really focused on AR as we should be, to be really honest. And I think that discipline and that focus is 100% here today, and it's been here for a while. And I don't think that if you look out over the next three or four years, that you're going to see the kind of fluctuations that you've seen five years ago. But we do have a couple of areas that we need to work on right now, and that's what we're focused on.

Ben Andrews

Okay. Well, that's good to hear. Hopefully, we'll see that going forward, kind of an ongoing lower DSO.

Kevin Miller

Yes. And we will absolutely get them down. The only thing I would add to that also is, we're very, very focused on obviously cash flow, return on equity. So if we have a client that we know is going to be 90 days or 120, and a lot of these big companies, it's 90, 120, or there's eight companies behind us that will take the business. We're pretty careful about how we select those companies. And we also need to make sure that if we're going to have high DSOs of the client that the juice is worth the squeeze, right? We're going to make sure that we get a good margin from that client to make sure that that capital allocation is worthwhile. So we spent a lot of time looking at this, and we spent a lot of time thinking about it very, very carefully.

Ben Andrews

Right. And that's why I'm asking this, because it clearly looks like it is, well, I know it's happened before, and I'm just trying to understand your customer base more.

Brad Vizi

Yes, but I'd also pair that and just to begin to put a fine point on what Kevin said, we look at DSOs in the context of overall returns on capital, right? So again, if a client's going to pay 50% gross margin, right, but they want to pay 90 days, and we feel it's absolutely good credit, great. And so, we try to be pretty holistic in the way we look at our client base. But also kind of a subtle thing here is, we're scaling a services platform, right? I mean, naturally that mix is, as you scale any business, especially one that has a diverse set of project activity like ours, it starts to normalize.

So you can get some gyrations from even just a couple of flare-ups or maybe one flare-up and one missed cut-off. And furthermore, on the administrative front, when we talk about administrative issues, right, they can be pretty fundamental. So we have a school client that ends up being a great client, but actually onboarding them is pretty, I would say, labor and intellectually intensive. And when you have that in place on that rhythm, right, and then all of a sudden you might have some turnover on their side. So the next person that comes in, right, you know, there's a little bit of a learning curve on that side, on their side again, right, in terms of picking up their own system.

So that could slow things down a little bit. So there's just some natural things that just happen, and as a whole, we view this long-term as opportunity, because anytime you have, you know, a pinch point with a client or a challenge in terms of getting to a point in a steady state where they're a great client, right, that ultimately is an opportunity to help them resolve a pinch point, so now instead of just being a vendor, you're a partner, right, and you become a little bit more sticky with respect to that partnership.

Ben Andrews

Thank you, Brad. If I look at earnings in the quarter, I was impressed. I mean, when you back out the gain on sale, like, for 400,000 from last year, clearly your EBIT went up more than I thought it was going to go up, and definitely more than the street analysts thought. And you did it with the health care engine not really running this quarter or being masked by stuff falling off. So how should I look at that type of margin looking out over a few quarters, when these schools and possibly aerospace, clients are coming on. Should you maintain relatively the same margin, or could we see nice growth like we did year-over-year in Q1 or even better?

Kevin Miller

Well, on a sequential basis, Ben, I expect it to improve on a sequential basis. I'm not going to sit here and tell you that we're going to see a catapult in gross margin from Q1, but we should see improvement as we move through the quarters. I mean, when we start running through 100% of unemployment expenses for a lot of our employees that alone will bring up the margins 50 basis points.

So, we should see some improvement as we go through. We had really good margins last year, so, I don't know how we're going to compare year-over-year, but I would also stress that Brad and I—while gross margin is incredibly important and something we really focus on, we focus on growing gross profit dollars and getting a return on those gross profit dollars. So, if it makes sense to sort of do a large deal for a 22% margin or a 20% margin, that's not going to have a lot of SG&A—a lot of direct SG&A, we'll do that. But as we look at the business today, I do expect to see some sequential improvements in gross margin for all three of the businesses.

Ben Andrews

Well, excellent. Hopefully the world realizes the work you've done and you've turned RCM back into a growth company again. And I don't know, I guess buying it, you can kind of get a double whammy, you can get that growth, and the stock is clearly trading at a market multiple, or well below a market multiple now on valuation-wise. So, let's see. Thank you for everything. I appreciate it.

Kevin Miller

Thank you, Ben.

Brad Vizi

We appreciate it, Ben. Thank you.

Operator

All right, gentlemen, at this time, there are no further questions in queue. If I can remind participants one final time, if you would like to get in a question, please press star, one on your telephone keypad. That's star, one on your telephone keypad.

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

Brad Vizi

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

Operator

And with that, ladies and gentlemen, this does conclude your call. You may now disconnect your lines, and thank you again for joining us today.