RCM Technologies, Inc.

Third Quarter Earnings

November 18, 2021

SPEAKERS

Kevin Miller, *Chief Financial Officer*

Bradley Vizi, *Executive Chairman*

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, and assumptions, and information currently available to us. 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.

Our third quarter results demonstrate tangible progress RCM Technologies has made over the past year. Our team's commitment to the process and execution of our vision has translated into tangible results. Compared to this point last year, the Company's business momentum and financial results have shown stark improvement. I will provide more detail regarding these improvements in a moment.

Over the past several quarters, we have discussed our steps to ensure these results continue to scale consistently. We have honed our processes and refined our focus. We have strengthened our balance sheet and made the necessary investments into our people. In essence, the foundation is now in place. I've also delineated our vision of RCM becoming a world-class services organization, and we remain steadfast in our commitment to ensure this becomes a reality. That said, we understand this journey requires a detailed roadmap capable of taking us from where we stand today to where we want to be in the future.

The roadmap to becoming a world-class services organization of the future requires us to embrace and help facilitate the digital transformation underway across every facet of the economy. That requires us to revamp our digital architecture to ensure scalability, but it also requires RCM to modernize the way we deliver solutions to our clients in the future. They need help in accelerating their digital adoption curve, and our mission is to assist them in getting there. In essence, the winners of B2B services in the future will be the ones who aggressively productize their solutions today. We are already beginning to see our efforts bear fruit.

As we've mentioned in the past, leveraging technology is a necessary ingredient to fulfilling our vision. We are prioritizing a range of strategic investments to revamp the Company's digital architecture. From our back-end systems to our front-end business development efforts, technology is augmenting our process every step of the way. As the economy's digital transformation accelerates, we are building out RCM's architecture to help facilitate a digital-first go-to-market strategy in the future. In doing so, we are beginning to capture a wealth of data that enables us to extract more data-driven insights that we can integrate into our approach to the benefit of our clients.

The revamping of our digital presence is one example, but we are also pairing that with investments in building out our CRM capabilities and modernization of our ERP systems soon. The efforts to modernize how we work internally also have the additional benefit of helping our clients innovate externally.

For example, our Engineering group's internal approach to project management has caught the attention of some of our largest clients. Our customers’ effort to modernize their process has led to our group's 3D4D project management tools to gain traction in helping facilitate large-scale projects at RCM's most prominent utility clients.

Another example comes from Aerospace unit. They are developing a patented solution for the Technical Publications group to help our clients digitize their mission-critical documentation in a sustainable and scalable way.

I will have more to share on our digital transformation efforts in the future. In the meantime, our team continues to execute against our strategic roadmap. I am pleased to share that they have put in another solid performance during the third quarter. I will provide several highlights before Kevin dives deeper into the numbers.

Our Q3 results were solid across the board. The team did a tremendous job, and in particular, our Healthcare group performed exceptionally well during the quarter. HCS segment for the third quarter increased 118% year-over-year, as the demand for healthcare professionals from our most significant clients continues to grow. I am also optimistic about the future as the group's momentum carries into Q4 2021, with demand from school districts for testing and nursing personnel remaining robust.

The Company's profitability was also strong for the third quarter. The Company generated Adjusted EBITDA of $1.9 million during Q3, representing an increase of about 780% year-over-year.

We ended Q3 with a favorable net debt position of $5.1 million, primarily the result of proceeds from the sale of our Canadian assets. As we enter our strongest seasonal quarter, we anticipate a material uptick in net debt toward the high end of our target range of 1 to 2 times EBITDA.

As we look to the fourth quarter and position ourselves for 2022, we remain optimistic that our operational momentum will continue.

In closing, our mission to become a world-class services organization requires us to modernize our solutions for a digital-first world. We have outlined the strategic roadmap that will help accelerate our organization and our clients' digital transformation efforts currently underway. I look forward to sharing more updates on our progress in the future.

Now, I will turn the call back to Kevin to discuss the Q3 2021 financial results in more detail.

Kevin Miller

Thank you, Brad.

Regarding our consolidated results, revenue grew over $13.9 million on a year-over-year basis, or about 44%, as compared to Q3 2020 while decreasing sequentially by $1.9 million after removing the impact from the Canada Power Systems' divestiture. Since summer school closings heavily impact our consolidated result in Q3, the sequential decline in revenue is sharply improved as compared to most years.

As Brad mentioned, Adjusted EBITDA in Q3 2021 was $1.9 million, an increase of about 780% year-over-year over $0.2 million in Q3 2020. Our Adjusted EBITDA in Q3 2021 even exceeded our Adjusted EBITDA in Q3 2019 of $1.1 million by about 70%.

Gross profit expanded to $12.1 million, a 38% increase over Q3 2020 and a 15% increase over Q3 2019.

Sequentially, SG&A expense increased by about $327,000 as we continue to invest in our team, our systems, and reward our employees for strong operational performance year-to-date.

Turning to our Healthcare division, as Brad mentioned, the group generated revenue of $19.6 million in Q3 2021, which represents a 118% increase year-over-year. The division's revenue seasonally decreased by $3.3 million compared to the $22.9 million generated in Q2 2021, exceeding expectations in our seasonally lowest quarter. Every unit in Healthcare performed well during the quarter, and the demand for healthcare professionals continues to be strong. We are optimistic about the group's Q4 '21 outlook as we close out the year.

Our IT division had another strong quarter with revenue and profitability both up sequentially and year-over-year.

On revenue, we generated $9.3 million in Q3 2021 compared to $7.5 million in Q3 of 2020 and $9.1 million in Q2 2021. The group continues to perform well, and we are making investments in sales and marketing to lay the groundwork for continued momentum in 2022. We expect a solid finish to close out the year in 2021.

Lastly, turning to our Engineering division, we generated revenue of $16.0 million in Q3 2021 net of Canada Power Systems, growing sequentially and year-over-year.

The Aerospace unit continues to perform well, and the backlog and pipeline are shaping up well as we head into 2022 with several new client wins.

Energy Services has maintained its momentum with the unit's backlog and pipeline continuing to improve. We are optimistic about the Engineering division's outlook heading into the fourth quarter and into Fiscal 2022.

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

Operator

Our first question is coming from Bill Sutherland. Bill, your line is open.

William Sutherland

Thank you. Hi, Kevin and Brad.

Kevin Miller

Good morning.

William Sutherland

Good morning.

Healthcare was a huge upside relative my expectations given the normal quarterly seasonality. Maybe talk about kind of how you bucked that trend in a little more detail.

Kevin Miller

Sure. Basically, it was really just strength across all of our businesses. The schools came back strong starting in October and September, and non-school revenue was strong. We had a lot of testing revenue in various places from COVID testing. Just the demand right now for healthcare professionals, which is probably not a big surprise to anyone, is incredibly strong, right, and we're just seeing strength across our entire group. Even our HIM group had a great quarter, and...

Bradley Vizi

Yes. The one thing I'd add to that, Bill, really quick, is I've always believed that there's an intangible asset in healthcare and that we're the largest purveyor of healthcare professionals to school systems here in the U.S., and what happens is, ultimately, that synergy effectively, I believe, feeds on itself, especially during times of distress like we saw here with the pandemic, so we believe that we are the go-to player in that space. We are the largest, and ultimately, we benefited from that.

William Sutherland

You had folks coming back to school. I understand the year-over-year, because it was so disrupted last year just as far as school attendance, but I guess the big upside was the non-school revenue, or were you just doing more services within the school contracts as well?

Kevin Miller

Both. Both.

William Sutherland

Okay, and I think you've added several contracts year-to-date, correct? School?

Kevin Miller

We have.

William Sutherland

Okay.

Kevin Miller

Yes, we have more schools, stronger participation in our core schools, and our non-school revenue is performing very well also.

William Sutherland

And last one...

Kevin Miller

(Multiple speakers) across the entire group.

William Sutherland

Yes, and then to what degree do you see it in your rates as far as the revenue growth as opposed to volumes?

Kevin Miller

Well, it's both. We've seen some uptick in some rates in certain instances. Some of the rates are prescribed by contract, but there have been some instances where we've been able to get some better rates in order to make sure that we get the people that they need.

William Sutherland

Okay, and then last, give us a little bit of a picture on the engineering pipeline. I know that you didn't expect it to be too different than second quarter this quarter, but how do you see it going forward?

Thanks.

Kevin Miller

We think we should see a meaningful uptick going forward. As you know, our Engineering group can be a little bit lumpy, just because we tend to win very big contracts, so while we may see a little bit of a lump in a quarter or maybe a little bit of a downturn, we expect a steady upward trend in our Engineering group on a go-forward basis, at least for the next couple of quarters.

William Sutherland

Is it pretty good across the groups, or is there...

Kevin Miller

I think it's pretty good across the groups. Certainly, in Aerospace, we've won some new contracts that we think should perform well. Sometimes you don't know until you actually implement them, but we're optimistic about all three groups, frankly.

William Sutherland

Great. Great, and then Kevin, the engineering revenue number for 2Q, how much is in there for—or how much was Canadian Power?

Kevin Miller

Are you asking for Q3, or Q2?

William Sutherland

Are you restating for the comps, or you're just going to keep this...

Kevin Miller

No. Well, we haven't restated revenues, but I can certainly give you the revenue, so we closed the Canada sale on July, and all this'll be in our Q, which will be filed by the end of today.

William Sutherland

Okay then, we don't have to take up the call. That's fine. That's fine. I'll just wait for the Q.

Okay. That's it for me, guys. Great job in the quarter.

Kevin Miller

Thank you.

Operator

Our next question is coming from Alex Rygiel. Alex, your line is open.

Min Cho

Good morning. This is actually Min Cho for Alex this morning. Congratulations on a good quarter. Just a couple of questions here.

Kevin, can you just break out the percentage of healthcare revenues from schools?

Kevin Miller

Let's see. In Q3, we had about $9.5 million of that was non-school and about $10.1 million was from schools.

Min Cho

Okay. Also, in terms of the margins, and I understand that it looks like you have strong momentum kind of across all of your segments here, but are the margins pretty sustainable at these levels assuming that the volumes kind of stay or improve from these levels?

Kevin Miller

Which group are you talking about?

Min Cho

Specifically in healthcare right now, but in general as well.

Kevin Miller

Yes. I think the margins in the short term are certainly sustainable in Healthcare. What's going to happen three quarters from now, a year from now, it's hard to really predict that, but certainly in the short term, we feel like the margins are very sustainable where they are right now. You might see some variation, obviously, but we feel like right now in this environment we'll be able to produce some strong gross margins in Healthcare on a go-forward basis.

Min Cho

Excellent, and again, I know that you were awarded some new school contracts in 2021. Have you determined some of those staffing needs going into 2022, and maybe potential impacts to 2022? Should we see a significant increase in healthcare revenue just from the non-school business?

Kevin Miller

We expect strong revenue in Q4 and Q1 in 2022, very strong revenue in Healthcare across schools and non-schools, and frankly, we don't have any reason to believe that after the next couple of quarters where we have more visibility, there's no reason for us not to expect that to continue. We're excited about the revenue-generating capability for our Healthcare business, for sure.

Min Cho

All right, and then just moving on to the engineering, I know you talk about aerospace a lot. I was just curious just kind of what your potential impacts are from the infrastructure bill, especially when it comes to your energy, kind of transmission distribution renewable segment. Can you talk a little bit about the progress that you're making there, any potential impact?

Bradley Vizi

Yes. No, we think that there's upside both in our T&D business, as well as our industrial business.

Ultimately, how that trickles in directly from the bill is to be determined, but probably more importantly, what happens is is overall uplifting spent in the space, so when you have a shoring up of funds like that, it provides more confidence to utilities to start to open up the spigots with respect to their Capex budgets, so we've certainly seen an uptick in activity, and looking for the numbers to improve going forward.

Min Cho

Excellent, and I know your life sciences business has been very strong for you. Can you talk a little bit about the labor issues there, if you're seeing any, or continuing to see them. And just is this an opportunity for acquisitions to add to life sciences services and headcount here?

Bradley Vizi

Generally speaking, on the acquisition front, we tend to be a little bit more opportunistic. I think, historically, if you look at our approach, we look at small bolt-ons of either acquisition targets or teams or very talented individuals that we can add to our platform and help them build their business.

It's funny. All of our businesses are very analogous to the example financial services where you have a fund manager that might be throwing up 25% a year for five, six, seven years, but he still only has $50 million of AUM, then suddenly gets a seed from a name-brand investor, 24 months later, it's a $2 billion AUM business. I think that that dynamic in our space is very, very analogous, and it's exciting. As a result, we haven't had to look at any major acquisitions to grow the business.

We believe that our platform brings a lot to the table for both (inaudible) the shareholders and all the stakeholders at RCM, so the ability to grow capital efficiently is probably one of the more attractive features to our business model.

And your second question with regard to the tightness of the labor markets, labor markets are tight, but ultimately, this is our business and this is what we do. We've been around for close to about 40 years. Our domain knowledge is very deep in the spaces in which we operate, and as you can imagine, you have a database and a rolodex and network that builds up, and ultimately intangible assets within those end markets in the form of reputation that allows you to attract clients and be able to tap into talent in a much more efficient way that can unlock value for the client, again, and the enterprise, so we're quite optimistic about how business is shaping up across the board.

Min Cho

All right, and then my final question is for Kevin.

Just regarding SG&A, obviously Brad talked about your digital kind of focus going forward. Sounds like SG&A will probably stay around this level as a percentage of revenue. I mean, it's definitely up over the last two quarters, but just if you can talk about (multiple speakers).

Kevin Miller

Well, certainly, we're going to be looking to drive that down as a percentage of revenue on a go-forward basis, but I think we expect a healthy uptick in revenue, so I think you should expect a healthy uptick in SG&A as well, and really across all of our businesses, but especially Healthcare.

Healthcare is incredibly busy sourcing candidates for all of our clients, and frankly, the more recruiters and the more recruiting infrastructure we can hire, the better. If I could add $1 million in recruiters tomorrow, and obviously, it's not that simple, but we would do it, right.

You should expect us to continue to try and drive our productivity up and SG&A as a percentage of revenue down while driving our SG&A up in terms of just hard dollars.

Min Cho

All right, and actually, I have one more question. Just Kevin, in terms of your margins in the engineering segment, was that just, again, kind of mixed issues in aerospace? If you can just talk a little bit to that, please.

Kevin Miller

Yes, I feel like, frankly, the margins in our engineering space for the last couple of quarters, frankly, have been disappointing, and there's a bunch of reasons for that, but I certainly expect them to improve on a go-forward basis. A big aerospace contract is one reason, but that's actually good because our operating margins on that contract are great, but we've had some other areas where we haven't managed the bench time as well as we'd like, and a few other reasons, but we've got our arms around it and we expect improvement in that area starting in Q4, frankly.

Min Cho

Okay, and when you talk about improvement, you mean sequential improvement from current...

Kevin Miller

Sequential improvement, yes. We're just under 23%. We should see some pretty—I expect to see some pretty significant improvement in Q4 on that.

Min Cho

Excellent. Great. Thank you. That does it for me today.

Operator

Our next question is coming from Frank Kelly. Frank, your line is open.

Frank Kelly

Yes.

Kevin Miller

Good morning, Frank.

Frank Kelly

Good morning. Good morning, Kevin. Good morning, Brad, and great operational results even with considering the Canada sale adjustment. Real kudos out to your operational heads, Bill and Mike and Mark and the engineering guys.

Just a question, with being in a great cash position and having significant and clean AR and a line of credit down, I guess based on total, to an insignificant level, and our business running, obviously and apparently, on all fours with operational momentum continuing, is the Board considering rewarding its shareholders for hanging in there in the past few years through the thick of it all, if you will?

Bradley Vizi

Yes, fair question, Frank.

Look, generally speaking, we think we've probably been one of the more shareholder-friendly micro-caps with respect to distribution of capital back to shareholders. As you noticed, they benefited from—many of the shareholders that have hung in there, frankly, have a negative cost basis from where they bought when you start to take into account the distributions that were on a tax-deferred basis that we made.

In addition to that, as you see, we have bought back a material amount of the stock outstanding, so as long as we can continue to improve the fundamentals of the business and operate it better and build it in a capital-efficient manner with fewer shares outstanding, again, we're quite optimistic of the outlook, so generally speaking, we're agnostic with respect to how we allocate capital, whether it be acquisition, buyback, or a return directly to shareholders in the form of dividend. We've done all of the above, and that'll continue to be our approach.

Frank Kelly

Right. Do we see anything specifically in the next Q with potentially a reward directly to the shareholders?

Bradley Vizi

Though that's something we discuss at least quarterly with the Board and Kevin and I, frankly, almost on a weekly basis, I don't think it'd be reasonable to expect a dividend per se. Also, the one thing to keep in mind, Frank, is for the first time in a long time, we're enjoying the benefits of having a clean balance sheet. There's a lot of optionality that comes with that, so with respect to distribution in the form of a dividend, I'd say it's unlikely over the short term, we are very much focused on opportunities to allocate capital reward shareholders over the long term, two of the largest of which you're speaking with on the call this morning.

Frank Kelly

Understood. Understood, but I appreciate the candidness, and it certainly belies our expectations as shareholders. Thank you, and have a great...

Bradley Vizi

Thank you for your support, too.

Frank Kelly

Okay.

Operator

Okay, it doesn't look like there are any more questions in the (audio interference).

Bradley Vizi

Thank you for attending RCM's third quarter conference call. We look forward to our next update in 2022.

Operator

This concludes your call.