RCM Technologies, Inc.

Second Quarter 2024 Earnings Call

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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

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, our 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 change. 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 second quarter.

Bradley Vizi

Thanks, Kevin. Good morning, everyone.

Second quarter growth was led by engineering, as project activity continues to ramp, building on the foundation carefully laid over the last several years. More important, engineering's leadership corroborates a fundamental aspect of the RCM thesis.

The success of our Company is not predicated on any one division or discipline. In 2022, performance was propelled by the success of Healthcare. In 2023, life sciences, data, and solutions were a key filler to maintaining the Company's trajectory, completing the transition to a post-COVID world. Now, in 2024, we are witnessing the emergence of a world-class engineering division with infrastructure to scale.

Five years ago, we presented RCM not as a healthcare company, not as an IT practice, nor an engineering outfit, but an emerging world-class professional services firm that can compete and win on the global stage. That was the vision then, and this is our reality today.

Also of note, we anticipate continuing strong contribution from engineering, along with increased strength in the other two divisions in the back half of the year.

Now, I will provide a more granular update on the progress of each of our teams, starting with Healthcare.

RCM's Healthcare division finished the school year strong. Looking ahead to the 2024/2025 school year, we are extremely encouraged about our prospects. We have successfully added many new school districts to our portfolio, several potentially requiring 50 to 75 new providers. While the exact value of these districts is yet to be determined, RCM has a proven track record of entering new districts and quickly becoming the primary vendor.

Our dedicated team is working tirelessly to streamline our recruiting and credentialing processes, reducing time it takes to bring new providers on board and into the field. This commitment to efficiency is not the cost of quality, but to ensure that we can meet the growing demand swiftly and maintain high standard of service our clients expect.

In addition to our domestic growth, we have significantly expanded our operations in the Philippines. This expansion includes not only increasing our recruitment team, but also building a robust operational support team. Investments in both our domestic and international operations, coupled with our unwavering commitment to efficiency and high standards, position us strongly for continued growth and success. We are not just hopeful, but confident that our efforts will drive significant value for our stakeholders as we continue to expand our footprint and enhance our service offerings.

In life sciences, data, and solutions, the second quarter showed continued progress as we implemented our solutions-integrated approach. We have seen a structural profitability increase relative to the historic performance and work to continue to strengthen the business. We believe our HCM practice is one of the premier partners in the industry.

For the eighth straight quarter, we have exceeded implementation quotas for one strategic client. In life sciences, our Puerto Rico team just completed a successful nine month, 15-person quality control project for a major pharma packaging company. Our life science commercial practice leads our growth as it continues to demonstrate its ability to assist clients to bring new products to market faster, cheaper, while improving compliance reporting.

We continue to see strong interest in our managed service offerings. We can support a broad range of functions, ranging from our industry-leading RPC, to quality, to validation and qualification, to application support. Transitioning to engineering, starting with energy services, the second quarter of 2024 demonstrated robust results, delivering revenue and EBITDA figures exceeding forecast.

Backlog remains solid and activity is healthy as we continue to execute against large engineering substation projects while maintaining high levels of client satisfaction. The EPC group maintains strong relations with existing clients, but also targeted additional potential customers for new projects in the U.S., including Puerto Rico.

To participate in the growing energy markets internationally, energy services is evaluating cooperation agreements in LATAM and Europe. The German office sees a significant increase in high-voltage substation demand and has begun staffing to prepare for further growth.

Increasing our market awareness, energy services continued a strong presence in most significant technical associations during the IEEE events in Puerto Rico and Anaheim, California, becoming a major contributor in the electrical engineering industry. For the upcoming CIGRE Paris session this August, energy services will present, together with a large U.S. utility, an innovative technical paper of a future-oriented microgrids substation.

In process and industrial, RCM Thermokinetics remains active in the zero-carbon chemical production market with three equipment projects in various stages of completion. The Thermokinetics office is also executing two ethanol plant optimization expansion studies that integrate the patented energy integration design, enabling clients to lower their carbon intensity score. The team is also completing a detailed process design for a planned SAF facility for a U.S. based customer.

Various tests are being conducted for our customers, utilizing test rigs for crystallization, filtration, and evaporation. The sales team is focused on the current market needs and has strategically pursued business in the lithium markets. That focus has yielded an engineering order placement this week for a lithium production facility in the United States.

The engineering order involves the development of the lithium solution chemistry and processing equipment design. The team also expects to close an equipment order for lithium refinement, which employs crystallization technology and downstream drying of crystals. This project is a good example of the strength of the TK team and the supporting test center.

The theoretical chemistry used in the lithium solution chemistry is complex and is de-risked by running the process in the test center with the chemical engineers who are designing the plant. The test center continues to gain momentum and is at 100% utilization through Q2 and well into Q3 2024. We continually evaluate further investment in additional equipment for the test center that benefits our clients.

RCM Thermokinetics recently presented at the Fuel Ethanol Workshop trade show in June. The focus, again, was plant optimization and identifying areas of improvement that our engineers excel at. The team remains focused on the continuation of our emergence as a market leader in responsible and sustainable chemical process design.

The aerospace and defense group had mixed results in Q2 2024 due to a slower than anticipated recovery in the aftermarket. However, EBITDA for the division remains healthy. The engineering business is thriving, executing with three or more new clients in Q2 2024.

Our estimate of realizing a healthy increase in EBITDA for 2024 holds true and the overall strategy remains the same. Recognizing most of our customers spend in the engineering domain. RFIs, RFQs, and MSAs expected to finalize have begun to produce new revenue in Q2 with an aggressive increase in headcount. Revenue and profit anticipated to escalate in the second half of 2024.

The most significant piece of the business that has had immediate impact is in the engineering arena with one of our new vertical lift customers, our current space customers, as well as our expansion into other divisions with one of our existing aerospace component manufacturers. We have realized much anticipated increases in customer requirements in Q2.

Our world-class recruitment team continues to successfully execute, which has allowed us to experience a noteworthy increase in new hires. We have experienced a 54% increase in new hires in Q2 2024 versus Q1 2024. We expect to see this increase quarter-over-quarter in Q3 and Q4. We continue to drive and expand our model-based expertise, software systems, mechanical and avionics expertise throughout the customer base in Q2 2024 with continuous inquiries and partnership opportunities as well.

Our new service offering involving solving quality and production issues within the supply base of our clients continues to grow with interest. New statements of work with major OEMs have been received with expanded skills and scheduled start in Q3, Q4 2024, and Q1 2025. We will continue to expand our reach with these clients and prioritize these engagements throughout 2024 and 2025. We have received three large RFQs for engineering and aftermarkets within our OEM client base and with a potential new client in the air mobility arena. The outlook for the second half of 2024 is bright.

Now, I will return the call to Kevin to discuss the Q2 2024 financial results in more detail.

Kevin Miller

Thank you, Brad.

Regarding our consolidated results, consolidated gross profit for the second quarter of 2024 grew by 6.6% as compared to 2023 from $18.8 million to $20.0 million.

Adjusted EBITDA for the second quarter grew by 10.8% from $6.5 million to $7.2 million. Adjusted diluted EPS for the second quarter of 2024 grew by 12.0% from $0.50 to $0.56.

As for our segment performance in the first quarter of 2024, engineering gross profit grew by 23.7%. Life sciences, data and solutions gross profit decreased by 17.9%. Healthcare second quarter gross profit grew by 8.6%. If we remove the impact of COVID from the comparable second quarter of 2023, we estimate that second quarter 2024 revenue grew by about 11.1%. If we remove the impact of COVID and the deliberate reduction in services to a large, long-time, but slow-paying rehab customer, we estimate that second quarter 2024 grew by about 19.1%.

School revenue of $30.8 million for the second quarter of 2024 grew by 23.0% after removing COVID revenue from the second quarter of 2023. While we certainly consider our non-school revenue important for our future growth, our Healthcare business is largely a school-based healthcare delivery model. Our year-to-date 2024 school revenue in 2024 exceeds 83%. The 2023/2024 school year is the third school year since schools returned from virtual school. The 2023/’24 school year is also the first school year to comprise zero COVID-related revenue.

We see some exciting trends, 2023/2024 revenue of $109.8 million grew by 24.9% over 2022/2023 after removing COVID-related revenue from the prior school year. Our non-COVID school revenue in 2022/2023 grew by 29.2% over 2021/2022. School revenue from the last pre-COVID year of 2018/2019 was $60.2 million, which we nearly doubled in 2023/2024. We now have 15 school districts that exceed $500,000 in revenue. In 2018/2019, we had three. For 2021/2022, we had five. We are optimistic we'll get this well over 20 school districts that exceed $500,000 for the 2024/2025 school year that begins in August-September of this year. As our new school pipeline is the best it's ever been heading into a new school year.

While we often don't know in July-August if a new school client will generate $50,000 or $500,000 in revenue, what I can say is that we've signed far more new school contracts for 2024/2025 than we have at any time in our long history serving school districts.

As for the second half of fiscal 2024, we are optimistic that we will continue to see 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

Yes, and with that, ladies and gentlemen, please press star one on your telephone keypad if you would like to join the question queue. That’s star one on your telephone keypad to join the question queue.

All right. First up, we have Alex Rygiel of B. Riley Securities.

Alex Rygiel

Thank you, Brad and Kevin. Very solid quarter. Nice to see you.

Kevin Miller

Thank you.

Bradley Vizi

Thank you.

Alex Rygiel

A couple of quick questions here. First, schools' business, obviously, it's doing fantastic. But the strengthening of schools' business and the commentary with regards to engineering and other segments, it all seems very bullish and more bullish than low double-digit EBITDA growth. I wanted to talk to you a little bit about maybe helping us to understand that, what I feel is maybe a conservative target.

Kevin Miller

Just bear in mind, we're talking about Q3 and Q4 of this year. A lot of that revenue is already baked. The schools don't really get going until the second week in September. They sprinkle into August and into September. We often don't know how strong they're going to start in terms of the new schools. Even some of the long-time clients sometimes start a little slow and then ramp up. We're very bullish on the school year in general. If you look at the numbers compared to 2023, we had a pretty big jump in Q4 from Q3. Basically, predicting a 10%-ish increase in EBITDA is already baking in a pretty nice increase in terms of the sequential movement of revenue and EBITDA. But, yes, we are being a little bit conservative, but that's by design because obviously things can change pretty rapidly, and we don't want to put big numbers out there, obviously.

Alex Rygiel

Brad, as you think about the next 12 months, from a revenue standpoint, which segment do you think grows the fastest?

Bradley Vizi

That's an interesting question. We think about the business every single day, so we can set—work with the team leaders to help set that business up for success T-plus-2, T-plus-3, and well into the future. Naturally, when you look at the strength of all three of these businesses being able to underwrite the success relative to one another over the short term based on drivers that were invested in and put in place potentially two, three years ago, it can become difficult from an underwriting perspective.

However, I think that this emphasizes a really key point, is quite a bit of confidence can be gained in the platform, this collection of businesses that was built up, when you think about the underwriting of outcomes, both short and long term. But when you isolate any one of the divisions over a short period of time, inevitably there could be some gyration that's expected and frankly unexpected. Sorry if it's a little bit too much or not enough, Alex, but I hope that answers your question.

Alex Rygiel

Lastly, balance sheet is pretty strong. Quick thoughts on capital allocation priorities.

Bradley Vizi

Yes, we've always tried to play this down the middle and just be very open-minded and flexible and be in a position to move opportunistically. Not necessarily manage the balance sheet to any one quote optimal capital structure but to be nimble and flexible, and be in a position to also manage a risk profile and keep it relatively low. With respect to share buybacks, obviously, we've been very active over the last several years, well over 40% of the Company at this point has been retired. At the same time, opportunities on the M&A front, the pipeline continues to strengthen. But we're not going to deviate from our baseline plan with respect to evaluating opportunities that we can bolt onto the platform that we believe we can grow substantially and have an alignment and culture and vision with the existing base. We always say one plus one equals five.

The near term in terms of the opportunity set the ones I think are probably the most relevant are in engineering. But that can change too. On the capital allocation front, like you said, we've been pretty consistent under a million, one turn of EBITDA of leverage. It's not that we're wed to that mark, but that seems to be right where things have fallen nice into place as far as the model.

Alex Rygiel

Very helpful. Thank you very much. Nice quarter.

Bradley Vizi

Thank you.

Operator

All right. Next up, we have Bill Sutherland of Benchmark.

William Sutherland

Thanks. Hey, guys. Hey, Brad, you mentioned a 54% increase in new hires for first half. If you could clarify if that's the timeframe and whether it's all of engineering?

Bradley Vizi

Yes, that's aerospace. Frankly, aerospace was a little bit more sluggish than we anticipated as a whole in first half. However, our confidence and the crystallization of that pipeline is improving. Those remarks are also aerospace.

William Sutherland

Okay. Thanks. A little dip in the quarter or more pronounced than you usually see in LifeSci. Is that just project timing?

Bradley Vizi

Yes. Good guess. That's a little bit of timing. We have a particular high margin project come to an end in Q2 of last year. Basically, what we're backfilling with start a little bit later in Q3. We actually think as you get to the back half of Q3 and into Q4, you should be a very healthy uptick in that business.

William Sutherland

Okay. When you, maybe Kevin, refers to school districts in the pipe, are those ready? Those are assigned and just, it's an implementation pipeline or is this a new business plan?

Kevin Miller

No. We have a significant number of school districts that are signed, over 20 actually. We think we're hopeful we'll sign over 30 new school districts heading into next year. That’s a really significant number. Now, on the flip side, I have to caution you because we get into these schools and sometimes we're pretty disappointed with the number of recs that we get.

William Sutherland

Yes.

Kevin Miller

But we've never been sitting here in July with the number of new school districts that we have for next year. Hopefully, we can penetrate, I don't know, meaningfully 10 of them, maybe more. We'll just have to see how it all plays out. But it's a real exciting time for the Healthcare business.

William Sutherland

Just to be clear, the 20 you've got signed up or more than 20, that's for the ‘25/’26 school year?

Kevin Miller

No, for ‘24/’25. They're starting in August, September. We're recruiting for some of these schools right now.

William Sutherland

Okay. The 30 (multiple speakers).

Kevin Miller

When I say ‘24/’25, just to be clear, and different schools in different parts of the country start at different times. They start anywhere from early August to early September. They end anywhere from early May to late June. When I talk about school years, I'm talking about our third and fourth quarter added to our first and second quarter for a school year.

William Sutherland

Right. Then last, just looking at the cash flow and seeing that second quarter in terms of operating cash flow is pretty much in line with first quarter. Should we think about the back half being like the first half?

Kevin Miller

I hope it's better. I hope it's better. I expect the third quarter should be strong because we have a drop in revenue due to seasonality. That naturally is going to goose cash flow. Obviously, the revenue spikes back up in Q4, which will hurt cash flow. But we're working hard to improve our DSOs in Q4 to offset some of that. When we look at the second half versus the first half, I expect second half cash flow, when you take Q3 and Q4 and add them together to be better than Q1 and Q2. I'll be disappointed if it's not. That's cash flow from operations, obviously.

William Sutherland

Okay. Thanks, both.

Operator

All right. At this time, there are no further questions in queue. For all participants, you can press star one on your telephone keypad if you want to get a last-minute question in. That's star one on your telephone keypad.

All right. We did get one more. Frank Kelly, the line is now open.

Frank Kelly

Gentlemen, great quarter. Certainly, seems to be on the right trend, a little bit improvement in AR. But can you shed some light, Kevin, on the SG&A line item? Year-over-year, it's up over 6%, and revenues, obviously, are not. But last year at this time, when we were on the call, we said, oh, well, we're investing, we're investing in infrastructure and whatnot and staff. We've been doing that now, obviously, for the last year. What drives that additional six-plus percent in SG&A? What are we doing to keep a pace on this?

Kevin Miller

There's really two general drivers of this. Three, I would say. One is just natural inflation of costs. Labor goes up, cost of technology goes up, rent goes up in some areas. That's one. Two is we're making a big investment in technology, and particularly cybersecurity is an area where we've had to put a lot of money into it just to keep up with making sure our Company doesn't get taken down by cyber threats. There's a lot of money that's been invested in cybersecurity and other IT initiatives. Of course, just investing in infrastructure to support the growth that we expect to come, especially on the healthcare side. If we over hire a little bit in healthcare, we'll figure it out later. But we'll hire as many recruiters in healthcare as we can find, just as an area.

We're continually investing in SG&A. By the same token, you know because you've followed the Company a long time, we continually look to prune SG&A as well. We'll continue to look for opportunities to bring—there's certain areas where you just can't bring it down and you just like the cost of being a public company, for instance, has just gone up incredibly over the last couple of years, like way above double digits. But we'll continue to look for opportunities. For instance, Brad mentioned something about opening up an office in the Philippines. We're going to continue to leverage some of the talent over there that is a lot cheaper than it is here. We'll continue to look to ways to grow our gross profit in an amount that significantly exceeds the growth in SG&A. That's the way we look at it, Frank. I don't pay attention as much to the revenue growth relative to SG&A. I look at the growth in gross profit versus SG&A. We can continue to improve that ratio, and we will.

Bradley Vizi

Yes, also, Frank, one thing I'd just add really quick, it's starting to think about the Company more as a $500 million company and $1 billion company. Naturally, when you look at RCM historically, the infrastructure, we under vested a little bit, frankly, in infrastructure. That was in our existing state. Now when you start to think forward, towards building a much larger company, an international company, inevitably in addition to catching up on some of that investment that brings a whole other profile of infrastructure. The good news is it's well underway as always, we're measured and thoughtful about how we add dollars into our cost structure. So far so good. As revenue growth and GP accelerate, naturally, the fall through should as well.

Frank Kelly

Great, understood. Things like bricks and mortar locations that are becoming more and more unnecessary at this point, I'm sure we're looking at those as well to bring down some of that expensive SG&A.

Kevin Miller

For sure. But our bricks and mortar costs have come down over the last couple years, Frank, which is obviously not going to be a surprise to you. But we do think that depending on the business, having bricks and mortar is really important. We don't need the same amount of space on a per square foot, per person basis that we needed six, seven years ago. But we still think it's really important to have bricks and mortar space for people to come to the office a couple days a week. Again, it depends on the business. There's some businesses that we have that are pretty much, 95% remote, and there's others that aren't.

But we'd like to have space where our employees want to come to work, and they want to collaborate, and they want to learn, and they want to get trained, it's important to us to have that space. We're not ever going to move to a fully remote company. But we're always looking to keep those costs down. I love sub-leases, and we have a couple of those that are pretty cheap, and we just continue to look to drive those costs down any way we can.

Bradley Vizi

Yes, Frank, next time you're in Pennsylvania, why don't you stop by HQ, and you'll feel pretty good about the leases that we're investing in. When you think about some of our higher leases, they tend to resemble more training centers, being much more functional. As you walk through the facilities it's pretty clear that there's an ROI associated with those investments.

Frank Kelly

Great. Will do. Will do. Thanks for the call.

Bradley Vizi

Anytime.

Operator

With that, gentlemen, there are no final questions.

Bradley Vizi

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

Operator

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