RCM Technologies, Inc.

2024 Year End 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

William Duberstein, *Stone Oak Capital*

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

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

Bradley Vizi

Thanks, Kevin. Good morning, everyone.

The fourth quarter demonstrated strong top line momentum as many of our strategic initiatives gained traction. Though our profitability in Q4 was a disappointment, there is a clear delineation of discrete items that materially impacted the quarter and are not indicative of earnings power. Kevin will walk you through the details to help provide a better sense of a more normalized figure that is in-line with our expectations for the business.

Perhaps most important, the internals of the business are in very good shape. Despite the tragic wildfires in Los Angeles and a number of school closings, we're witnessing a resumption of growth in hours and increasing activity throughout most of the business. Though the economy is migrating through a period of increased macroeconomic uncertainty, we take great care in working to insulate the business from these forces. In fact, we entered 2025 with considerable optimism due to the continued effort of our devoted employee base to position the business for secular success.

I will now provide an update on the progress of each of the business units. RCM Health Care closed 2024 on a high note that includes the resumption of growth in hours, as we lap the strategic de-emphasis of a slow-paying, long-term care client. Our existing school district partnerships continue to deepen with increasing client penetration and a growing number of providers. Additionally, we head into 2025 with a robust pipeline of new school districts and clients, positioning us for continued expansion.

Many of our long-standing contracts, which have matured into well-established business lines are also experiencing good growth. The continued expansion within these accounts reflects both the strength of our relationships and the quality of our services. Core to our strategy, with increased value we deliver to each of our strategic accounts comes commensurate share gains and increased defensibility. A key driver of our growth in K-12 has been the surging demand for behavioral health services.

Schools across the country are facing an unprecedented mental health crisis among students with an estimated one in five children experiencing a mental health disorder, and the demand for school-based behavioral health services has continued to grow. School districts increasingly prioritize mental and behavioral health support, leading to a surge in demand for specialized providers, including school psychologists, social workers, para-professionals and behavioral therapists. As a result, our ability to rapidly deploy highly-qualified professionals has positioned us as a leader in addressing this critical need.

We are also excited about the strong performance of our corrections clients. We demonstrated impressive growth in 2024. This sector remains a key area of opportunity and we anticipate further expansion in the year ahead. Consistent with the strategy we employ throughout the Company, we aim to benefit from the success of our initial accounts and leverage our learnings to tailor solutions that will allow us to further penetrate the market segment.

As we move into 2025, we remain committed to smart growth, operational excellence and delivering unparalleled service to our clients. We look forward to capitalizing on the exciting opportunities ahead and building on the strong foundation that we have established.

In Q4, financial indicators for our life sciences, data and solutions division continued to show improvement as we delivered continued positive growth of our managed service contract portfolio. Q4 revenue projections were in line with our expectations, exceeding GP and NOI targets for the quarter.

Fourth quarter managed services growth also reflects further cost savings measures, including offshore delivery and productivity tools. In our HCM division, we continue to exceed quarterly quotas by utilizing advanced quality improvement techniques and creation of support utilities. We continued to deliver successfully on our managed solution initiatives and secured three new clients. Furthermore, RCM was awarded multiyear renewals for three of our managed service engagements, demonstrating client loyalty and consistent quality delivery. Overall, our Q4 performance reflects the efforts the division has invested in securing long-term extended managed services contracts.

Twenty-twenty-five will see a dramatic shift in our primary markets. Traditional IT services of business analysis and application development will be replaced by deployment of AI and ML tools that support key process automation. We have positioned ourselves to assist our clients to adopt these new paradigms and create opportunities for competitive advantage.

Transitioning to engineering, starting with energy services. Demonstrating robust annual growth, 2024 was another year of strong performance. Energy services' customer-oriented mindset was key to promote this growth and to meet the requirements of the power and utility industry. The continuation of professional, high-quality service execution was well-received by major energy utilities in North America, resulting in further negotiations for upcoming large-scale projects. These include the grid modernization of the U.S. and increased demand for data center developments, serving as a rapidly emerging driver of growth for RCM.

Additionally, energy services EPC group developed a teaming agreement with a major construction company for executing large upcoming turnkey projects. RCM Europe continues to demonstrate strong progress. With a third EPC project awarded and several new projects in negotiation, we are looking forward to our German office providing a healthy contribution in 2025. We are particularly pleased with the quality of the talent we have been able to secure in a talent-constrained environment. RCM's reputation as a thought leader and significant contribution to internationally recognized projects is paying dividends.

Meticulous care in scaling up our core team of professionals helps ensure solid project execution and lays the foundation for RCM to become a long-term trusted partner for Europe's energy transition as we add a second large utility in Germany to our world-class client list. Energy services continued to contribute with active leadership roles in major technical associations such as IEEE PES and SF6 & Alternatives Coalition hosted by NEMA. The team will participate in the CEBA Colloquium (phon) 2025 and will be a sponsor and main contributor to the IEEE PES Substation Meeting in New Orleans in May.

In Process & Industrial, the RCM Thermal Kinetics office has successfully designed and launched a new plant expansion program primarily focused on the ethanol industry. The next campaign has already resulted in an equipment order for $3.5 million. The project expands a plant from 85 million gallons per year to 100 million gallons per year. The team has received several quality leads from marketing and client outreach efforts. The office expects two to three additional engineering orders in Q1 and Q2 for next projects. We believe the 12 month to 18 month ROI our solution targets for clients will result in additional equipment orders following our frontend engineering efforts.

Also of note, Thermal Kinetics has completed an engineering order to develop novel solution chemistry for a customer-planned lithium facility in the U.S. A several month pilot campaign at the TK Test Center is expected to begin in Q1, utilizing brine extracted from U.S.-based wells. The equipment for this facility is scheduled for purchase in late 2025. This project is a great example of the strength the Thermal Kinetics Test Center brings to the team.

We believe the ability to prove the simulated chemistry greatly improved the likelihood of our selection as a process engineering lead for the project. The test center also concluded a challenging evaporation test for a U.S.-based client for an expansion project in Mexico. This is another example of utilizing testing capabilities, as a route to market. The $7.5 million equipment order associated with this test is planned for early Q3. Thermal Kinetics is continuing efforts to finalize an expanded partnership agreement with a U.S.-based client. TK has been an exclusive vendor utilized for the past seven years to support this customer's proprietary CO_2 capture and conversion plants.

The team remains focused on continuation of their emergence as a market leader in responsible and sustainable chemical process design. The aerospace and defense group continued to win business on new programs with existing and new clients in Q4 2024, which allowed us to consistently grow our resource base. Headcount has increased an additional 20% in Q4 2024 over Q3 2024, which was already a significant increase over the first half of 2024. As projected, we have realized a healthy increase in EBITDA for 2024 compared to 2023. The weekly run rate continued to increase an additional $65,000 in Q4, which amounted to a top line increase of $1.3 million quarter-over-quarter.

As previously mentioned, the RFIs, RFQs and MSAs that were finalized in 2024 have allowed us to realize an aggressive increase in headcount, revenue and profit, which we expect to continue to increase through 2025. Our vertical of customers and technology innovator customers doing business with the U.S. government and Tier 1s has reinforced our expansion across air, land, sea, space and cyber. We have also experienced growth throughout new design programs in engineering as well as established long-term supported products in manufacturing with increased aftermarket demand as well.

All anticipated requirements throughout our customer base in Q4 2024 have now been surpassed as we begin 2025 in a much better place than years past. The recruitment team continues to build trusted, valued relationships throughout the client and candidate base, which has allowed this team to exceed all hiring expectations in 2024.

We continue to embark on new tools and technologies to maximize the reach and efficiencies of this team. One of our newest awards have just begun to gain traction, and we expect these new multiyear contracts to drive and expand our model-based expertise, software systems, logistics, avionics and aftermarket expertise throughout 2025 and 2026. We expect to continue to grow with all our aerospace and defense clients in 2025 and beyond as we are the cost-effective, flexible and high-quality workforce solution that is needed in this environment. We look forward to solidifying additional clients and program wins in 2025.

Now I will return the call to Kevin to discuss the Q4 2024 financial results in more detail.

Kevin Miller

Thank you, Brad.

Regarding our consolidated results, consolidated gross profit for fourth quarter of 2024 was $21.6 million, flat as compared to the fourth quarter of 2023. Consolidated gross profit for fiscal 2024 was $79.8 million, compared to $76.7 million for fiscal 2023.

Adjusted EBITDA for the fourth quarter was $6.3 million, as compared to $8.9 million for the fourth quarter of 2023. Adjusted EBITDA for fiscal 2024 was $25.9 million, compared to $26.6 million for fiscal 2023. Adjusted EPS was $2.03 for fiscal 2024, as compared to $2.04 for fiscal 2023. During Q4 '24, we had several material expenses move in the wrong direction. In our Engineering group, a significant industrial process equipment order was abruptly canceled midway through the project. Also, our technical publications group experienced significant rework on a large project with one of our aerospace clients. These two items caused an approximate $900,000 reduction in gross profit in Q4.

Additionally, our self-insured medical plan had abnormally high medical costs that increased SG&A expenses by about $1.25 million from what we would normally expect. We settled a class action lawsuit regarding California wages in 2023, but the judge denied the initial settlement in 2024 and sent it back to the attorneys. We had to go back to mediation. We now have an approved settlement agreement, but it added about $450k in SG&A expenses between the increased settlement costs and the additional legal fees.

As for segment performance in the fourth quarter of 2024, in engineering, gross profit for the fourth quarter of 2024 was $5.2 million, compared to $6.1 million for the fourth quarter of 2023. Gross profit for fiscal 2024 was $22.5 million, compared to $20.6 million for fiscal 2023. Gross margin for the fourth quarter of 2024 was 19.7%, compared to 27.0% for the fourth quarter of 2023. Gross margin for fiscal 2024 was 23.4%, compared to 24.3% for fiscal 2023. Gross margin in the fourth quarter of 2024 was very low, primarily due to the two expenses mentioned earlier, but also because we had a high mix shift of lower-margin work in Q4. Our engineering gross margins can be very volatile, but we generally expect them to land between 24.0% and 28.0%.

In IT, life sciences and data, solutions, gross profit for the fourth quarter of 2024 was $3.9 million, compared to $4.5 million for the fourth quarter of 2023. Gross profit for fiscal 2024 was $14.7 million, compared to $16.2 million for fiscal 2023. Gross margin for the fourth quarter of 2024 was 40.0%, compared to 38.7% for the fourth quarter of 2023. Gross margin for fiscal 2024 was 37.5%, as compared to 38.2% for fiscal 2023. We generally expect IT, Life Sciences and Data Solutions gross margins between 36% and 40%.

In Health Care, gross profit for the fourth quarter of 2024 was $12.5 million, compared to $11.0 million for the fourth quarter of 2023. Gross profit for fiscal 2024 was $42.5 million, compared to $39.9 million for fiscal 2023. Gross margin for the fourth quarter of 2024 was 30.0%, compared to 29.8% for the fourth quarter of 2023. Gross margin for fiscal 2024 was 29.8%, as compared to 29.3% for fiscal 2023. We generally expect Health Care gross margins to be between 28% and 30%.

School revenue for the fourth quarter of 2024 was $34.9 million, compared to $29.8 million for the fourth quarter of 2023. Non-school revenue for the fourth quarter of 2024 was $6.2 million, compared to $6.9 million for the fourth quarter of 2023. However, if we remove a large long-term care group where we deliberately reduced services, revenue would be $5.6 million in 2024 versus $5.5 million in the fourth quarter of 2023. Regarding our trade accounts receivables, we made some headway this quarter going from 114 DSOs for the third quarter of 2023 to 92 DSOs for the fourth quarter of 2024.

We had two balances at the end of fiscal 2024, both of which were cleaned up in the first quarter of fiscal 2025. First, a large school client stopped payment early in the fourth quarter due to administrative issues unrelated to the Company. The Company estimates that this school client's December 28, 2024 accounts receivable balance exceeded normalized levels by about $6 million.

An IT, Life Sciences, Data and Solutions client stopped making payments while we negotiated change orders and a two-year contract extension. The Company estimates that the client's December 28, 2024 accounts receivable balance exceeded normalized levels by approximately $3.8 million.

Our goal for DSOs is to get to under 80 by the end of fiscal 2025. Our goal for all quarters in fiscal 2025 is at least double-digit growth on Adjusted EBITDA, and we are very optimistic about 2025. We'll give more guidance as the year progresses, and we'll have another call in May, which is not too far away.

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

Operator

With that, ladies and gentlemen, if you do have any questions, please press star, one on your telephone keypad. Once again that's star, one on your telephone keypad to join the question queue. All right, ladies and gentlemen, just again, that's star, one on your telephone keypad if you wish to join the queue. Star, one on your telephone keypad if you wish to join the queue.

All right. We do have a William Duberstein. Your line is now open.

Kevin Miller

Hey, Bill.

William Duberstein

Hey, guys. Hey, hey, nice to talk to you again. Thanks for all that detail on the extra costs. You went through a bunch of line items, and I might have missed this, but it looks like your—was any of that realized in the tax rate? Because it looks like the tax rate was over 50% this quarter. I'm not sure if…

Kevin Miller

Yes. Bill, the tax rate, obviously, in the fourth quarter is a function of the tax rate for the year. You really can't look at the tax rate in the quarter. You need to look at the effective tax rate for the Company overall. The effective tax rate is 34.0%. When we file the 10-K later, you'll see a rate reconciliation. Certainly, if you have any questions on it, feel free to give me a call. But, I'll just say that the 34.0% effective tax rate is very, very high for us and very abnormal.

What is driving a big chunk of that is permanent differences having to do with truing up deferred tax liabilities. It doesn't impact your cash taxes, but it impacts your GAAP taxes. About 5% of that is stuff that we don't normally see. The upshot of it is, absent anything I'm not aware of, we should not see a tax rate anywhere near 34% next year, an effective tax rate. It should be well below 30%.

William Duberstein

Do you have a range of what a so-called normal tax rate might be…

Kevin Miller

Sure. I would say normal, a range would be 26% to 29%, and probably the midpoint of that is probably a pretty good guess. The more we make—the more pretax we make, obviously, that rate is going to come down some because your permanent differences have a lower impact on your rate. But in a normal year, we don't typically have big, big permanent differences. If you ignore permanent differences altogether, our rate's around 26.5%. But if we were above 27.5% next year, it would surprise me. On an effective tax rate basis.

William Duberstein

Great. Thanks for that. For the specific cost on engineering, I think you called out an order being…

Kevin Miller

Nine-hundred-thousand dollars.

William Duberstein

The $900,000.

Kevin Miller

Total for the two items that occurred. That's an increase to direct costs, essentially. It's a combination of increased direct cost and essentially lost revenue that we expected to get in the fourth quarter. You wind up with a little bit lower revenue and higher costs, and the end result is about $900,000 in lower gross profit than we would have had absent those two items.

William Duberstein

Right. Sorry, was one item resulting in lower revenue and one item increased cost or…

Kevin Miller

No, they're both resulting in lower revenue. Obviously, the canceled order reduced revenue. Then when we have people doing rework, they're essentially working with hours that would normally be billable and would normally generate revenue, and you're not generating any revenue because we're doing work for free essentially. In that case, you're losing revenue on people that normally would be generating revenue. It's both. You have higher—then you wind up with a real crush to your gross profit dollars and your gross margin.

William Duberstein

The client doesn't recompense you for the work done before the project was canceled?

Kevin Miller

Well, yes, but we certainly cut it off. But the way the contract works, we still lose significant revenue by canceling the order midstream. Had we completed it, we would have delivered equipment and we would have made a lot more money on it than having a canceled order.

William Duberstein

Right. I don't know if you can go into these details, but did that canceled order have anything to do with sort of the change in administration? Obviously, the election happened early November. I was just wondering if either that…

Kevin Miller

No.

William Duberstein

Okay.

Kevin Miller

No, there's no political factors there. It's just a nuance with a particular client.

William Duberstein

Okay. I guess that led me to wonder if there is any sort of effect you're seeing from maybe like DOGE or any sort of the headlines that are out there, considering some of your clients are government contractors or may receive money from some government agencies?

Kevin Miller

No direct—nothing direct. I mean I think DOGE can potentially have some impact on the IT environment in general, not talking about RCM. I mean we don't do—most of our work for government is working as a subcontractor, and most of that work is in the aerospace industry. We don't—as of today, we don't expect any major impact. Certainly, if a lot of IT workers are getting laid off because of DOGE that can impact the IT environment in general. But like we don't see any direct link as of today to any major impact on RCM. I'm sure Brad probably could expand on this, but that's what we're seeing today.

Bradley Vizi

Yes. No. Real quickly, I'd just echo Kevin's sentiments. The other thing I see playing out, we seem to generally be insulated from, when you start to think about the services business, and particularly ours, the times where you do have blips and material reductions in workforce, inevitably, they overshoot. The first one has actually come back onto the contractors like us. As I see all this playing out just like you do, and we are, again, managing the business every single day to continue to move the ball on the field, and we're not really seeing an impact. The more I see this play out, the more I think to myself, at some point, these reductions in workforce, when are we going to be on the right end of overshooting.

In other words, like these government reductions, you are bringing people back. Those people that you just let go, oftentimes, they're dispersed into the broader economy and they find different jobs, and you have a gap left to fill pretty quickly. It's too early and there's too much uncertainty with respect for me to pound the table either way. But it hasn't been an impact today, and we're optimistic that, at some point, it may actually be a tailwind.

William Duberstein

Okay. That's encouraging. My final thing, it looks like, absent those onetime charges, you guys would have grown operating income a little over 12%. That's obviously much better. Did you say you were looking towards double-digit bottom line growth every quarter or for the full year? I'm just wondering if…

Kevin Miller

Well, yes, at least that for the full year, right, because we had a disappointing fourth quarter. But we strive to grow our Adjusted EBITDA quarter-over-quarter every quarter in the low double digits. That's our goal, okay, is to grow at least in the low double digits. We don't see any reason why we can't accomplish that in 2025. I mean, Q4 2025 is sort of a long ways away. I don't think we're going to see sort of the hockey stick in numbers that we saw in 2023, which we thought we might see in 2024 that we didn't see. But our expectation as a Company is to grow Adjusted EBITDA low double digits every quarter. If we don't, then it's a failed quarter, frankly.

That's how we ring it up on the scorecard. If we don't hit those numbers, then it's a failed quarter. As we look out at 2025, we're optimistic. We don't see any reason why we can't hit our goals. I'll just, I'll leave it at that.

William Duberstein

Great. Very encouraging. Thanks very much guys. I'll leave it to someone else.

Operator

All right. With that, I'll remind participants you can press star, one on your telephone keypad if you would like to ask a question. That is star, one to join the question queue. We're seeing no further questions in queue. Please press star, one on your telephone keypad. Still no questions in queue.

Bradley Vizi

Okay. Thank you, everyone for attending our year-end call. We look forward to our next update in May.

Operator

All right. Ladies and gentlemen, this does conclude your call. You may now disconnect your lines.