RGP

To the Power of Human™

Resources Global Professionals

Fiscal 2021 3rd Quarter Earnings Conference Call Prepared Remarks

Good afternoon ladies and gentlemen, and welcome to the Resources Connection, Inc., conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. If anyone should require assistance during the conference call, please press the "star" key followed by the "zero" button on your touchtone phone and you will be connected to an operator who will assist you. As a reminder, this conference call is being recorded.

At this time, I would like to remind everyone that management will be commenting on results for the third quarter ended February 27, 2021. They will also refer to certain non-GAAP financial measures. An explanation and reconciliation of these measures to the most comparable GAAP financial measures is included in the press release issued today. Today's press release can be viewed in the Investor Relations section of RGP's website and was also filed today with the SEC.

Also, during this call, management may make forward-looking statements regarding plans, initiatives, and strategies and the anticipated financial performance of the Company. Such statements are predictions, and actual events or results may differ materially. Please see RGP's Report on Form 10K for the year ended May 30, 2020, for a discussion of risks, uncertainties and other factors that may cause the company's business, results of operations, and financial condition to differ materially from what is expressed or implied by forward-looking statements made during this call.

I'll now turn the call over to RGP's CEO, Kate Duchene.

Kate Duchene, Chief Executive Officer:

Thank you, Operator. Good afternoon everyone and thank you for joining us. With me today are Tim Brackney, our Chief Operating Officer, and Jennifer Ryu, our Chief Financial Officer.

I will start with an overview of the third quarter, which I am pleased to report showed continued improvement. I will then discuss opportunities that are building as we execute on our defined strategy. Next, I will provide an update on our digital initiative, HUGO, and close my remarks with insights on the macro environment that we believe bode well for Fiscal 22 and beyond. Then, I will turn the call over to Tim and Jenn for further color and detail.

From a revenue perspective, we delivered $156.6 million in Q3, representing a sequential improvement of 3.4% same day, constant currency despite the seasonal holiday impact. This performance continues to narrow the year-over-year decline caused by the global pandemic. Fourth quarter trends continue to show improvement.

Another highlight from our financials this quarter is the 200-basis point improvement in Adjusted EBITDA margin from prior year performance, driven by sequential revenue improvement and cost improvement of 12% year-over-year, excluding contingent consideration and restructuring cost. We remain focused on improving our margin performance as we continue to drive top line growth, extract operational efficiencies and lower costs, including real estate expenses.

I want to now make a few remarks about our strategies and how they align with opportunities that have been building throughout this fiscal year. Results achieved during this quarter reinforce – more so than in any other prior quarter -- our strategy to build more capability in the digital and technology and healthcare practice areas. Both practice areas are delivering growth despite COVID impact. Specifically, Veracity's revenue was up 20% year-over-year and we believe the pipeline of opportunity is near pre-COVID levels. Healthcare opportunities across the client set of payor/provider, medical device and pharma are all increasing as projects that were delayed due to COVID reemerge or new needs created by COVID arise. For example, we are currently engaged in multiple significant projects in the areas of revenue integrity, continuum of care, vaccine distribution, and clinical trials development. We also recently entered into a multi-year contract with a preeminent Group Purchasing Organization in the healthcare space and have seen our pipeline continuing to expand. Additionally, technology and digital revenue continues to rise as a percentage of our overall mix.

Now for a quick update on our digital transformation initiatives, specifically HUGO. For anyone who is new to our story, HUGO is our digital engagement platform to offer clients and talent the opportunity to connect digitally for project work in the accounting and finance space with speed, transparency, and choice. What is special and different about our platform is the foundation of employment versus an independent contractor model. We have purpose built this platform for the professional knowledge worker who wants the safety net and community of employment with the agility and choice of a gig-oriented career. We believe HUGO will be one of the first platforms to revolutionize how accounting and finance professionals join the fluid workforce of the new gig economy.

We are in the final stages of product development, testing and marketing readiness for the initial roll-out of HUGO. We will launch HUGO first in the New York/Tristate area, although specific timing remains fluid. We are keeping a close eye on market conditions for launch to ensure the pandemic recovery is stable enough to support on premise work if required. Many clients are in various stages of office reopening plans, so we will carefully evaluate their readiness when determining the final timeline for launch. We're excited that this digital engagement model creates a new pathway to serve clients and consultants with user experience at its heart. We believe this approach will only grow in the coming years as digital natives become our core buying set.

Let me now share a few insights on trends materializing on the anticipated backside of COVID, which we believe should serve as longer-term drivers for our business. We know the economic environment is strengthening. GDP growth is expected to exceed 6% in the US this calendar year, according to the Fitch Ratings Global Economic Outlook March 2021 report. And in the other regions in which we operate they project growth in the range of 5 to 8%. Last week The Conference Board reported that consumer confidence is the highest it has been in a year, and last week's jobs report beat expectations. Staffing Industry Analysts also projects US staffing revenue to grow 12% in 2021.

Specifically, for RGP's clients, COVID has hastened the shift to fluid talent strategies as a dynamic force for improving corporate performance. In other words, in a world filled with technology change, demographic shifts, and economic uncertainty, having the right talent in the right place at the right time has become an imperative to compete and thrive in today's business environment. Add the dimension of evolving labor preferences toward remote work, additional flexibility and increased choice, and the human capital marketplace has drastically changed. These factors explain why a growing number of large enterprises will now define staffing needs with agility in mind. A recent study published by Harvard Business School and BCG Henderson, after surveying 700 business executives in companies with more than $100 million in revenue, highlighted the importance of adopting a strategic approach to an on-demand workforce. Here are a few of the salient research findings from that study:

· 60% of the executives surveyed expect that they will increasingly prefer to rent, borrow or share talent with other companies.

· Almost 90% of business leaders report agile talent platforms will be somewhat or very important to their organization's future competitive advantage.

· And nearly 50% of the executives expect their use of new digital platforms to increase significantly in the future.

We believe that this research, like many other studies recently published, confirms that the "Full Time Equivalent" paradigm is yesterday's framework. Agile or fluid talent strategies are taking hold today, play right to RGP's strengths and capabilities, and will accelerate as we move forward in the Now of Work.

I will now turn the call over to Tim for his operational update.

Tim Brackney, President & Chief Operating Officer:

Thank you, Kate, and good afternoon everyone.

During the quarter we saw progress in our revenue and operating metrics, as clients embraced the start of a return to normalcy. Top of the funnel activity is approaching pre-pandemic levels, as new and existing buyers have become more eager to discuss current and future initiatives. Opportunities identified through our enhanced outreach led to an appreciable increase in pipeline and closed engagements. As the overall macro environment continues to improve, our revenue has also gained strength. As Kate touched on, sequential quarterly revenue trended up 3.4% on a same day constant currency basis despite seasonality, buoyed by the positive dynamic of clients resuming engagements that have been paused, starting projects that were delayed and generally committing to larger spend on initiatives, including initiatives that have been driven by the changes to the workforce paradigm as a result of the pandemic. COVID has and still does present challenges for our business; at the outset demand creation was challenged, however, as client initiatives have continued to ramp – it has impacted timing in terms of engagement starts creating a lag between closed/won engagements and revenue generation. We are seeing improvements in this dynamic as well, but timing continues to be fluid on an engagement-by-engagement basis.

Overall momentum coupled with our ability to deliver borderlessly has given us capacity to pursue a more robust set of strategic initiatives. While there have been increased calls for on-prem resourcing, we also continue to deliver with blended teams, and still in many cases fully remotely. We believe that a blended approach will be the standard operating model going forward, as we serve clients that are comprised of increasingly distributed teams and have become more conditioned to flexible ways of engagement - focusing on outcomes versus zip codes. We have seen numerous examples of this, including helping a large consumer goods company headquartered in the UK drive trade promotion efficiencies and benefits through better process and tooling using advanced analytics, machine learning and AI. Our delivery team for that project has worked both on site and remotely and is based in various localities across Europe and North America.

Another example is the fast-ramp assistance we delivered to a client for SPAC readiness. This was a quick turn and featured a multi-city team delivering in a blended fashion to help prepare our client to go public and then comply with on-going public company requirements around financial systems, Sarbanes-Oxley and equity administration.

As we have stated before, we believe this new way of working is here to stay, and that it allows us to operate with increased efficiency while offering clients and consultants more choice and agility. As we push into more of a post-pandemic environment, we believe that utilizing a mixture of traditional and remote delivery models will be critical in a commercial environment rife with pent-up demand. Specifically, our ability to capitalize on speed-to-market and to spin-up solutions that produce the desired outcomes was one of our core competencies before the pandemic and has been further enhanced by lessons learned during the last year. We believe that this foundation provides the backbone for growth and profitability as we fully embrace life in a borderless world.

Now let me turn to our third quarter operations. During the quarter we began to see a strengthening pipeline and increased average daily revenue rates. This strengthening increased throughout the quarter, partially offset by some of the adverse weather effects that impacted parts of North America and renewed COVID outbreaks in parts of APAC and Europe. Nonetheless, average daily revenue rates ended the quarter at the highest they have been in nearly a year; enterprise revenue grew sequentially despite typical seasonality; and pipeline and booked revenue also nearly reached pre-pandemic levels. Average daily revenue rates in Europe ended the quarter nearly matching pre-Covid levels despite some latent outbreaks, while North America also continues to make good progress. In fact, the majority of North American markets continued sequential progress, while several markets, including Tri-State, Detroit, Cleveland, Toronto, and Mexico, had Q3 revenue results that exceeded the prior year quarter. APAC was slightly down sequentially due to renewed waves of COVID and some holiday impact, although Japan continued their strong run improving both sequentially and over the prior year quarter. Finally, there was continued strong performance from Strategic Client Programs, Healthcare, Veracity, and Countsy which either equaled or exceeded prior year quarter results and are building strong pipeline.

We are laser focused on strategic growth and expansion, and we are also concentrating heavily on operating leverage. Executing in a more borderless fashion, continued migration to a more agile footprint and consistent focus on expense management has yielded improvement in operational leverage and a reduction in SG&A. We believe as we return to a more open economy, our discipline around driving operational efficiencies, combined with our increased sophistication in adapting to the new modalities we use to meet, deliver and commune will allow for a more efficient and effective operating model in the future. We will continue to invest in the areas where we see upside opportunity and allow us to elevate and widen our relationships within our client base, including in HUGO, digital and technology, healthcare, client programs and office of the CFO.

Before handing over to Jenn, I want to provide some additional insight on early fourth quarter trends. The early weeks of Q4 have shown a continuation of positive trends in both revenue and growing pipeline. While we are optimistic given operational indicators and broad economic trends, we recognize that there is still some fluidity in the macro environment.

I will now turn the call over to Jenn for a more detailed review of our third quarter results.

Jennifer Ryu, Chief Financial Officer:

Thank you, Tim, and good afternoon everyone.

Starting with an overview of our third quarter results –

- Revenue continued to improve sequentially despite the typical holiday impact. Gross margin was in line with our expectation given this typical seasonality. SG&A continues to benefit from our restructuring initiatives as well as our increasingly virtual operating model. We delivered a solid

6% adjusted EBITDA margin, a 200-basis point expansion from the same period last year.

- Our balance sheet remains strong with an increase in available liquidity during the quarter, and we continue to generate positive cash flow from operations.

Now let me provide more color on our operating results starting with revenue-

- We generated $156.6 million of revenue, a 2.2% increase sequentially, and a 6.8% decrease from the comparable quarter a year ago, narrowing the year over year revenue gap. After adjusting for business day and currency impact, revenue increased 3.4% sequentially and decreased 10.4% year-over-year.
- North America led the sequential improvement with a 5.8% increase on a same day constant currency basis, largely driven by a 12% growth in digital transformation services, and a 3% improvement in both healthcare and financial services.
- Europe and Asia Pac revenues sequentially declined by 7.1% and 5.6%, respectively. Europe was primarily impacted by the reinstitution of lockdowns in Germany and to a lesser extent, the expected shrinkage from unwinding our businesses in certain European markets in connection with the restructuring initiative. Asia Pac's revenue recovery was hindered by heavier adjacent impact from various holidays in the third quarter.
- Our third quarter gross margin was 36.4%, down 10 basis points from the prior year quarter. The change in gross margin was largely due to a slight decline in the bill/pay spread.

- Comparing to Q2 of fiscal 21, gross margin declined by 160 basis points, primarily due to an increase in payroll taxes at the start of the calendar year as FICA earnings reset.
- The average hourly bill rate for the quarter was approximately $125, up from $123 in the prior year quarter and $124 in Q2 of Fiscal 21. The average pay rate for the quarter was $64, up from $63 in both the prior year quarter and the prior quarter sequentially.
- SG&A expenses for the quarter were $49.5 million after excluding $2.7 million of contingent consideration expense and $0.7 million of restructuring charges, a meaningful improvement of $6.7 million compared to the prior year quarter.
- Reflecting the benefits from our restructuring efforts, management compensation costs were reduced by $3 million and occupancy costs were reduced by $0.9 million compared to Q3 of fiscal 20.
- General business expense also continued to improve, down $1.6 million compared to Q3 of fiscal 20, due to reduced travel and reduced discretionary spend.

Turning to the other components of our financial statements –

- Income tax provision was $1.1 million, representing an effective tax rate of 60.5%, compared to an income tax benefit of $4.0 million in the prior year quarter. The increase in effective tax rate for the current quarter was driven by our inability to realize any tax benefits on losses in certain foreign entities due to required valuation allowances. Prior year quarter’s tax benefit included a discrete tax benefit of $6.6 million relating to certain deductions we took upon dissolution of entities in the Nordics.

- Adjusted diluted EPS for Q3 of Fiscal 21, which excludes the net of tax impact of restructuring charges, stock compensation and contingent consideration, was 14 cents per share compared to 25 cents per share in the prior year quarter, which included the favorable impact of 18 cents per share from the discrete tax benefit just mentioned earlier.
- Our balance sheet remains strong. We ended the quarter with cash and cash equivalents of $84 million compared to $96 million at the end of Fiscal 20. We generated approximately $35 million of positive cash flow from operations in the first nine months of the fiscal year and paid down $35 million of outstanding debt under our credit facility.
- We maintained our 14 cent per share quarterly dividend in the third quarter.
- We remain prudent in managing our liquidity considering the lingering impact of the pandemic and the near-term cash requirements to fund our digital transformation efforts.

I'll close with our fourth quarter outlook and an update on client statistics–

- Given the pace of recovery from the pandemic and the increasing stability in the macro environment and in our business, we are pleased to provide guidance for Q4.
- We expect continued revenue growth in the fourth quarter, in a range of $164 to $167 million. Gross margin is expected to rebound from the third quarter given fewer holidays and is expected to be in the range of 37.5 to 38%. From an SG&A perspective, we expect to achieve sub 30%in a quarter during which the topline is still recovering from the pandemic, estimated to be in the range of $48 – $50 million.

- Finally, RGP's client continuity was outstanding this quarter and we believe our retention statistics demonstrate the value add we bring to clients every day. During Q3, we served 49 of our top 50 clients from Fiscal 2020 and 45 of the top 50 from 2019. This stickiness has remained consistent year over year despite the global pandemic. In addition, for Q3, our top 50 clients represented 42.5% of total revenues while 50% of our revenues came from our top 80 clients. Reflecting our efforts to continue to diversify our solution mix, 94% of our top 50 clients procured multiple services or functional expertise from RGP during the third quarter, an improvement from the start of the second half of the year.

Now, we are happy to take questions.