RGP

To the Power of Human™

Resources Global Professionals

Fiscal 2021 2nd 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 telephone 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 second quarter ended November 28, 2020. 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 second quarter, including the ongoing progress we are making to overcome COVID 19 impact. Then, I will share updates on our two most significant priorities this fiscal year: our digital transformation and evolving our delivery model to be more flexible, virtual and borderless to drive growth within our client base – existing and new geos, client programs and healthcare. This evolution also supports our focus on EBITDA improvement. I will then share client continuity statistics to reinforce our stickiness in a blue-chip core client base and improving continuity quarter over quarter. Finally, I will close by touching on a few highlights from our new investor deck added to our website today.

From a revenue perspective, we saw steady improvement in top line results as we moved through the quarter, the impact of the global pandemic notwithstanding. In Q2, our revenue at $153.2 million was a 4.0% sequential improvement over Q1 and grew 6.4% when comparing revenue based on same number of billing days and constant currency. Excluding our restructuring charges, SG&A also improved as expenses were reduced 4.7% sequentially. Adjusted EBITDA margin increased 120 basis points sequentially to 8.1% as a result of our cost reduction initiatives and expense discipline. We are continuing to pursue bottom line growth through operational efficiencies, lowered real estate investment and headcount management. In his remarks next, Tim will discuss some of the positive revenue trends that are emerging, as well as steps we are taking to maximize opportunity in our core geographies, client programs and healthcare industry practice as we continue to position the Company for sustained success in the coming years.

Now, let's turn to our two primary growth priorities this fiscal year. The first is to grow revenue by providing more digital transformation services and building out new digital pathways to engage for staffing services. Over the last several years, explosive technological innovation has fueled the rise of digital transformation as a corporate imperative. Our clients have been forced to rethink the way they do business, to stay ahead and compete with digitally native new entrants. In order to support our clients – including these digitally native businesses, RGP has evolved significantly to help clients automate, streamline and drive efficiency through functional process redesign, technology migration, project management and communication services. These initiatives are happening in every functional area of our clients – finance and accounting, risk and compliance, tax, human resources and project management.

To effectively address this evolution, we had the foresight to acquire Veracity in 2019 to help us build end-to-end digital solutions for our clients who strive to automate workflows and increase collaboration – which has become even more important given the increasingly virtual nature of today's workforce. The past year has not only reinforced and accelerated the digital mandate for all corporations, it has placed an emphasis on the employee experience given remote work – which is a specialty of Veracity's.

Given an integrated Go-To-Market plan in fiscal 21, RGP and Veracity are uniquely positioned to capitalize on the emerging trends, combining Veracity's robust capabilities around workflow automation, leveraging premier platforms like ServiceNow and Akumina, with RGP's deep functional expertise and process orientation. Veracity achieved record revenue during the quarter and this trend has continued in Q3. We have also experienced growth in our cross selling success across the enterprise, with Veracity bringing RGP into project work and vice versa. We expect this positive momentum to continue through the second half of the fiscal year; although remember, Q3 for all parts of our business is impacted by holidays.

With respect to our digital engagement platform development, HUGO progress continues as planned. We have finished the Talent Management Release and that part of the software is in active use with a select set of candidates and internal management. We are on track to bring this digital engagement offering to market by the end of this fiscal year. We will, however, ensure that the macro environment is stronger and more fully recovered from lockdown scenarios when we bring the product to market and we will share more detail as that timeline approaches. We're excited that this new digital engagement model will bring transparency, choice, efficiency and speed in striking the right professional match for much sought after talent in the finance and accounting realm.

Our second growth priority initiative this fiscal year is to continue to evolve our delivery to be more fluid, virtual and borderless. This initiative is intended to enhance both revenue and earnings as it is directly linked to client acquisition – new and existing – and cost efficiency. For example, we have recently closed several projects with consultant teams pulled together from multiple geographies to deliver an exceptional experience for clients. This type of approach would not have happened pre-Covid when we operated with a more traditional geo-focused mindset. We are also demonstrating that we do not need physical offices to serve clients effectively. For example, we just closed a new, multi-consultant engagement on a project out of Des Moines where we do not have a physical office or go to market team. This exemplifies the opportunities we are starting to uncover with new client sets. As Jenn will also outline, we have made strong progress on our real estate consolidation plan which we will continue to drive forward. All of these actions help us continue to streamline our cost structure while bringing our client delivery teams closer together and closer to client buyers.

Next, RGP's client contunity was outstanding this quarter. These retention statistics demonstrate the value add we bring to clients each and every day. During Q2, we served all our top 50 clients from fiscal 2020 and 46 of the top 50 from 2019. This stickiness has remained consistent year-over-year despite the global pandemic. In addition, for Q2, our top 50 clients represented 44% of total revenues while 50% of our revenues came from 70 clients. Our largest client for the quarter was approximately 3.5% of revenues. Also, during the second quarter, 90% of our top 50 clients procured mutiple services or functional expertise from RGP which demonstrates our ability to build revenue beyond the origins of our finance and accounting roots and is an improving trend as we start the second half of the year.

In closing, I am also pleased that we posted to our website today a new Investor Deck to kick off 2021. Our new presentation synthesizes our heritage, our exciting future, and our relentless focus on shareholder value creation. We have also expanded our disclosure around Environmental, Social and Governance topics. This is particularly important to us in our efforts to become the employer of choice for high quality professional talent who want to work differently with a community and company that cares about profit and purpose, the importance of diversity, equity and inclusion, and operating as a force for good in community and individual life. The advent of the Fifth Industrial Revolution is here, and it will be squarely focused on bringing humanity back to the workplace. When you have a look at our new investor presentation, we think you'll agree that RGP is very well positioned to deliver what talent and clients want today.

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 continued to embrace our de facto operating model of virtual delivery and the utilization of borderless talent. We saw positive movement in revenue and operating metrics, as well as an appreciable increase in project teams working on large client initiatives. As the overall macro environment began to improve, our weekly revenue and pipeline also gained strength. As Kate touched on, sequential revenue trended up 6.4% on a same day constant currency basis buoyed by increased client spend on project initiatives and some seasonal tailwind tied to year-end activities. Project management and communication become even more important with rising demand, as we continue to operate mostly virtually, traversing time zones to deliver projects. We've seen this demonstrated on numerous occasions, whether it be assisting an operational transformation for a west coast entertainment client leveraging talent from Honolulu, Miami and Houston; or assisting a Pacific Northwest Healthcare client transform their delivery and operations with talent from Atlanta, Orange County and the San Francisco Bay Area. This more seamless matching of supply and demand has allowed us to operate with greater efficiency which was increasingly important as demand continued to rebound during the quarter.

Our ability to successfully deliver in a remote fashion provides a critical qualification which will impact the buying decisions of clients in a post-COVID environment. We believe this successful evolution of project delivery coupled with our clients' increased leverage of a distributed workforce has permanently changed our commercial environment. It opens up our ability to fashion solutions using a mixture of traditional and virtual delivery models bound together by our strength in agile co-delivery, project management and commitment to holistic communication. This new market dynamic will provide a strong foundational underpinning, as we enter into the second half of the fiscal year, and initiate planning for FY22 which will include expansion of client programs, leveraging broader market talent for virtual delivery and increased focus on account penetration.

Now let me turn to our second quarter operations. As noted in our first quarter remarks, we began to see a strengthening pipeline and increased daily revenue rates. This strengthening increased throughout the quarter as daily revenue rates reached levels that were the highest since April. While Q2 demand was still impacted by the pandemic, North America and Asia Pacific saw sequential increases in daily revenue rates – as did Europe, which I will focus on in a moment. Client Programs and Healthcare led the charge in North America which also saw strengthening in key core markets, including Tri-State and the California and Texas markets. Asia-Pacific also delivered positive rates and was consistently trending at nearly pre-Covid rates by the end of the quarter.

We neared completion of a significant restructuring in Europe during the second quarter impacting approximately 40% of the workforce and resulting in a cessation of operations in France and Italy. I am extremely proud of the European team and their unwavering focus on clients and consultants during very difficult economic times. Despite working through this reorganization, our European practice banded together, renewed its focus on our most important clients and actually increased daily revenue over Q1.

Notable growth in demand especially related to larger projects also positively drove volume and quality of pipeline. In fact, activity and pipeline were both strong in the quarter, and while there remains uncertainty related to the macro environment, given current operating trends, we could see sustained progress emerge as we move forward.

While we remain keenly focused on growth and expansion opportunities within existing clients and markets, we are also concentrating heavily on operating leverage and efficiency. We are utilizing a more virtual and agile footprint, and this new operating style coupled with continued focus on expense management has yielded SG&A improvements of 4.7% sequentially and 11.1% from prior year quarter, after excluding restructuring costs. We will continue to be judicious about expense discipline, and will continue to invest in areas where we can achieve high returns. In particular, digital and technology, healthcare and client programs continue their strong performance and offer opportunity to deepen and widen our relationships with important clients.

Before handing over to Jenn, I want to provide some additional insight on early third quarter trends. The early weeks of Q3 have shown a continuation of positive trends in both revenue and growing pipeline, with daily revenue up approximately 8% over Q2. While we remain wary given the fluid macro environment, these positive indicators and some of the news around vaccine development and distribution are certainly encouraging.

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

Jennifer Ryu, Chief Financial Officer:

Thank you, Tim, and good afternoon everyone.

Starting with an overview of our second quarter results –

- Revenue notably improved this quarter compared to the first quarter. Gross margin was in line with our expectation given typical seasonality with Thanksgiving holidays. SG&A continues to benefit from our restructuring initiatives as well as our increasingly virtual operating model. As a result, we delivered a solid 8.1% adjusted EBITDA margin despite the ongoing Pandemic.
- Our balance sheet remains strong with an increase in available liquidity during the quarter, and we continue to generate positive cash flow from operations.

RGP
To the Power of Human™

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

- We generated $153.2 million of revenue, a 4% increase sequentially, and a 17% decrease from the comparable quarter a year ago. After adjusting for business day and currency impact, revenue increased 6.4% sequentially and decreased 15.6% year-over-year.
- Same day constant currency revenue increased sequentially by 5.0% in North America, 14.3% in Europe and 10.2% in Asia Pac.
- Compared to the prior year quarter, same day constant currency revenue decreased 16.8% in North America, 7.9% in Europe and 13.0% in Asia Pac.
- Our second quarter gross margin was 38%, down 130 basis points sequentially and down 230 basis points from the prior year quarter.
- The reduction in gross margin was largely due to more holiday pay as a result of Thanksgiving as well as a decline in the bill/pay spread. Compared to the first quarter of fiscal 2021, lower payroll taxes toward the end of the calendar year mitigated a portion of the gross margin decline.
- The average hourly bill rate for the quarter was approximately $124 compared to $123 in the prior year quarter and $124 in Q1 of fiscal 21. The average pay rate for the quarter was $63 compared to $61 in prior year quarter and $62 in the prior quarter sequentially.
- SG&A expenses for the quarter were $47.8 million after excluding $6.8 million of restructuring charges, a meaningful improvement of $6 million compared to the prior year quarter.
- We continue to realize more cost improvements this quarter as we make progress executing our restructuring initiatives. Management compensation costs were reduced by $2.5 million and occupancy costs were reduced by $0.8 million compared to Q2 of fiscal 20.

- General business expense also improved, down $1.8 million due to reduced travel and reduced discretionary spend.

Turning to the other components of our financial statements –

- Income tax provision was $2.3 million for the second quarter, representing an effective tax rate of 178.5%, compared to 30.2% in the prior year quarter. The effective tax rate for the current quarter was driven by higher international losses, largely resulting from the restructuring costs incurred in our European entities, and our inability to realize any tax benefits due to required valuation allowances.
- Adjusted diluted EPS for Q2 of fiscal 21, which excludes the net of tax impact of restructuring charges, stock compensation and contingent consideration, was 21 cents per share compared to 42 cents per share in the prior year quarter.

Next let me provide an update on our progress in executing the restructuring plans:

- We have substantially completed the reduction in force including those carried out under the European plan in Q2.
- We set out to exit from 22 real estate locations under the restructuring plans, of which 11 have been completed.
- To date, we incurred total restructuring charges of $12.8 million, of which $7.8 million was incurred in the first half of iscal 2021. We expect between $2 to $4 million of additional charges before completing the remaining actions, mostly related to real estate. The timing of the planned real estate exits will depend on a number of factors, some of which are not within our control, but we are committed to executing on our plan.

- As I mentioned earlier, we have already realized significant cost reductions in the current fiscal year as a result of these actions. We anticipate additional savings in the remainder of the fiscal year as the benefits from the European plan take full effect.
- Longer term, we expect to continue to rationalize our real estate footprint beyond what's planned under restructuring, and continue to control our discretionay and travel spend by taking a blended approach between traditional and virtual methods of client engagement and delivery.

Now let me turn to our balance sheet and liquidity:

- Our balance sheet remains strong. We ended the quarter with cash and cash equivalents of $97.2 million, up slightly since the end of fiscal 20. We generated approximately $30 million of positive cash flow from operations in the first half of the fiscal year and paid down $20 million of outstanding debt under the amended credit facility.
- The board of directors maintained our 14 cent per share quarterly dividend in the second quarter.
- We remain vigilant in managing our liquidity considering the ongoing pandemic, the near term restructuring related cash obligations as well as other cash requirements to fund our digital transformation efforts.
- In the long term, we will continue to evaluate our capital allocation strategy and expect to return cash to shareholders through both dividends and share repurchases, while balancing debt repayment and the capital requirements of growing our business both organically and strategically.

I'll close with our recent change in segment reporting and a discussion of third quarter trends–

- The execution of the European Plan in the second quarter resulted in changes to our internal management structure and our reporting structure of financial information used to assess performance and allocate resources. Effective second quarter, our businesses are organized and managed in three operating segments, RGP, taskforce and Sitrick.
- RGP is over 90% of our business and drives the trends of our consolidated enterprise. Please refer to our press release and form 10Q for additional disclosure regarding segments.
- Now looking ahead to Q3, average weekly revenue for the first 3 non-holiday weeks of the quarter was $13.3 million. We expect typical seasonality in the third quarter around our revenue as well as gross margin. From an SG&A perspective, while we anticipate cost savings from restructuring to continue, we typically experience higher SGA in Q3 due to the reset of payroll taxes at the start of the calendar year.
- Lastly, consistent with our approach last quarter, we will not issue any specific revenue or earnings guidance for the third quarter of Fiscal 21 given the ongoing uncertainty as it relates to the pandemic.

Now, we are happy to take questions.