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Resources Global Professionals

Fiscal 2021 1st 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 turn the call over to your host today, Ms. Lauren Elkerson, General Counsel of Resources Connection. Ms. Elkerson, you may now begin.

Lauren Elkerson, General Counsel:

Thank you, operator. Good afternoon everyone, and thank you for participating on this call. Joining me here today are Kate Duchene, our Chief

Executive Officer, Tim Brackney our Chief Operating Officer, and Jennifer Ryu, our Chief Financial Officer.

During this call, we will be commenting on our results for the first quarter ended August 29, 2020. By now you should have a copy of today's press release which is available on our website.

During this call, we may make forward-looking statements regarding future events or future financial performance of the Company. Such statements are predictions, and actual events or results may differ materially. Please see our Report on Form 10K for the year ended May 30, 2020, for a discussion of risks, uncertainties and other factors such as seasonal and economic conditions and epidemic diseases. Such factors may cause our business, results of operations, and financial condition to differ materially from results of operations and financial conditions expressed or implied by forward-looking statements made during this call.

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

Kate Duchene, Chief Executive Officer:

Thank you, Lauren! Congratulations on your new role as our General Counsel. Welcome to our Q1 FY21 Earnings Call. Thanks for listening today.

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Let me start with an overview of the first quarter, including the continued impact of COVID on results. I will then comment on industry trends followed by commentary on current RGP opportunities and priorities. Tim will offer deeper operational color and Jenn will dive into specific financial performance and early Q2 financial trends.

As expected, our revenue results are still impacted by the global pandemic. Our revenue at $147.3 million was down 14% year over year. Gross profit was $57.9 million in the quarter compared to $67.5 in the prior year quarter. However, our gross margin of 39.3% represents an improvement of 10 basis points from prior year quarter, thanks, in part, to pricing discipline. In addition, adjusted EBITDA remained steady as a percentage of revenue at 6.9, consistent with prior year quarter, which we attribute to focused cost reduction and rationalization initiatives. I am also proud to share we were able to achieve revenue growth in pockets of the business despite COVID impact. These bright spots included Veracity, Countsy and our Strategic Client and Key Account programs.

So far in the second quarter, we're starting to see a broader-based uplift in both revenue trends and pipeline growth. Average deal size is growing and our "at-bats" are rising with significant improvement in meeting metrics in AsiaPac and North America. We are also continuing to close numerous extensions – especially as many clients tackle year-end, mission critical activities. The near-term opportunity areas we continue to pursue aggressively include: rising demand for digital transformation services across all industries; data analytics, clinical trial and revenue cycle opportunities in our healthcare client segment; and organizational change management needs given enterprise shifts to virtual operating models. Tim will dive deeper into these growth opportunities.

Let me next revisit the most important industry trends we believe support opportunity to grow our business over the short and longer term. I have discussed these trends in prior calls but we anticipate acceleration given impact of the global pandemic. As recently reported by The Conference Board, flexibility is moving to the forefront. CEOs and C-suite executives globally rank workforce flexibility as a priority initiative -- including enabling remote work and flexible hours, increased use of contingent labor and creation of agile project teams. In another recent research study by Citrix, with futurist consultancy, Oxford Analytica, and research firm Coleman Parkes, most C-suite executives said that by 2035, traditional employment models will become rare. They plan to utilize high-value knowledge workers in the form of on-demand talent working through platform models. Needless to say, workforce strategies are evolving quickly, and the pandemic only serves to hasten this process. We believe RGP is well positioned to benefit from these shifts given our depth of experience in managing variable talent for well over two decades.

Now I want to turn to current RGP priorities, which I introduced on the last call. With regard to our digital expansion efforts, which are high on my agenda, we continue to make progress, including growing our Veracity business and developing the human cloud product. I will take each in turn.

Veracity had a strong Q1 and is trending up in Q2. The revenue growth has come from net new clients as well as extensions of existing projects. During the quarter, we also closed the first ever digital project in RGP's Strategic Client set. This first project for a life sciences client is already building to a second and third opportunity. It is this sort of penetration that we are very focused on delivering in FY21. In addition, Veracity's business is positively impacted by the enhanced focus on improving employee experience during these challenging times. We see strong opportunity for digital to drive collaboration, automation and self-service in worker and customer experience. This is where Veracity shines and we know can deliver.

Progress continues as planned on the development of Hugo, our human cloud product. We're on track to bring this platform offering to the market this fiscal year, and will share more detail as we get closer to launch. We're excited that this new digital engagement model will delight both clients and talent alike by bringing transparency, choice, efficiency and speed in striking the right professional match.

Our second priority area for FY21 centers on further strengthening core operations. We continue to build revenue growth and impact with our Strategic Client and Key Account programs. We have nowcombined the initiatives around these client sets into what we now simply refer to as "Client Programs." In FY20, despite the impact of COVID, we grew this client set by 15%. This quarter, again despite the overall revenue dip and seasonal vacation impact, these programs grew 1%. We continue to invest in building broader and deeper relationships in these important clients so we become stickier and reduce time-to-close. This type of initiative takes time and focus but is paying off in all regions.

Equally important to core strength is the success of our Healthcare industry program. Many of our largest clients are healthcare or life sciences enterprises with significant transformation projects underway. In particular, we see tremendous opportunity in revenue cycle, clinical trials development, supply chain and digital transformation within this buyer set. Current opportunities include assisting a very large integrated delivery network (provider and payer) with a side by side operational benchmarking of their multiple medical centers to identify process improvements and cost savings opportunities. Another current healthcare payer project of note is leading the development of their business case analytics and process models to determine their three-year IT investment strategy related to digital innovation for member experience and operational excellence.

Our third main area of focus for FY21 is a commitment to cost containment. While managing cost is always important for its own sake and especially given today's macro environment, we're looking to free up investment dollars to redirect to higher impact areas – like our Client Programs, digital expansion and targeted M&A opportunities. In early September, following a thorough strategic review process, we launched an important initiative to reimagine our European business. Through this restructuring work, we will enhance account and revenue focus, streamline management and accelerate virtual delivery. Jenn will discuss more in her remarks, but this initiative follows the Project Strength work we initiated in early March for North America and Asia Pacific. Reimagining Europe serves to both strengthen our core and leverage down cost, so it hits two of our three priority areas for FY21.

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.

In this quarter, we continued to work efficiently in a virtual manner. In fact the selling and delivery of projects remotely is no longer a novel part of our business, but our de facto operating model, a trend that has been underway for some time. As the economy opens up, our ability to flex seamlessly between traditional on-premise and virtual models will offer greater optionality in how we deliver projects and our go-to-market motion. Supply and demand alignment is a key operating principle which can be truly streamlined in a world of borderless talent. Removing the constraint of geo-fencing our consultants based on locality has opened up new avenues of opportunity for both our clients and our talent. As an example, we virtually on-boarded a multi-country engagement team to help a Life Sciences client integrate a newly acquired division. This project was sold and is being delivered virtually to the delight of our client. I am really proud of the way we have worked in numerous instances like this to deliver engagements wholly virtually and look forward to seeing our teams combine on-site and virtual capabilities to sell and deliver projects for clients and prospects in a post-COVID world. This enables us to attract and retain talent on a broader geographic basis, and allows for a wider field of play in terms of prospect cultivation, client engagement and project delivery. We believe that this agile way of working is not a temporary trend but a meaningful shift in the way we work. We're exceptionally well positioned to handle this change, and believe this represents a net benefit to our Company and clients.

Now let me turn to our first quarter operations. As noted in our fourth quarter remarks, we saw declining weekly velocity and pipeline towards the end of the fourth quarter. Uncertainty related to the economic environment prompted delays of new engagements and some slow down of existing projects. Additionally, on-boarding at some clients was challenged due to hardware and software constraints as the shift to virtual environments has depleted laptop inventories . As we moved through the fourth quarter however, we were able to stabilize operational metrics with velocity, pipeline and activity holding steady throughout the quarter. By the beginning of the first quarter, both velocity and pipeline stabilized, with average weekly velocity down approximately 11% sequentially. We began to see upward momentum emerge towards the end of August, as we neared the end of vacation season in North America. Europe followed a similar velocity to North America while Asia-Pacific, which experienced COVID-related decline and stabilization in Q3 of FY20, is heading toward recovery.

Our margins have remained strong through the course of the current quarter and deal pricing remains consistent. Additionally, virtual delivery and travel restrictions have reduced the amount of engagement delivery expense, positively impacting margins. We have been disciplined and flexible in pricing and will continue to be, as clients still need to deliver on key projects and work through transformations. There is increased client demand for project codelivery which is a core competency; we are staying close to potential buyers and remain willing to invest in key relationships.

We continue to be focused on growth and expansion within existing clients and markets. We are working hard to position ourselves for what we feel will be a post-pandemic world rife with opportunity. As Kate noted, we will continue to manage expense; this discipline around discretionary spend and a commitment to operating with a smaller footprint has yielded SG&A declines of 17.5% sequentially and 10.2% from prior year quarter. We will be judicious about re-investing those savings, but will not shy away from investing in parts of the business where we achieve the highest return. These include client programs which managed to grow quarter over quarter, Veracity which offers access to new buying centers, and the Healthcare and Technology industry sectors, which have built a robust pipeline despite the economic climate.

Before I conclude my remarks, I want to provide some additional insight on early second quarter trends. The early weeks of Q2 have demonstrated sustained upward momentum in both velocity and pipe. Average non-holiday weekly velocity in the early part of the quarter has increased 2.2% sequentially over Q1 although lags the prior year quarter's non-holiday average by 12.4%. Likewise, the pipeline has increased significantly from the early part of Q1 and is also strengthening in quality. These positive indicators are certainly encouraging, but we remain vigilant given potential macro developments outside of our control.

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

Jennifer Ryu, Chief Financial Officer:

Thank you, Tim, and good afternoon everyone. Starting with an overview of our first quarter results.

- Revenue was impacted by the global pandemic this quarter. We sustained gross margin through pricing discipline. While gross profit was down due to the decline in revenue, we realized significant cost savings and delivered solid operating profit.

- Importantly, through effective cost containment efforts and prudent cash flow management, we generated positive cash flow from operations in what is normally a cash outflow quarter. In addition, our balance sheet remains strong with an increase in available liquidity by the end of the quarter.

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

- We finished the quarter with $147.3 million of revenue, a 14.4% decrease from the comparable quarter a year ago, and a 17.5% decrease sequentially. After adjusting for business day and currency impact, revenue decreased 15.7% year-over-year and 12.1% sequentially.

- North America's same day constant currency revenue decreased 15.3% compared to Q1 of fiscal 20. Included in North America's revenue this quarter was $5.7 million of revenue from Veracity compared to $1.4 million in the prior year quarter, due to the acquisition occurring part way through Q1 of fiscal 20.

- Europe's same day constant currency revenue declined by 16.5% compared to Q1 of fiscal 20, of which 8.5% was related to the exit from the Nordics.

- Sequentially, same day constant currency revenue decreased by 12.5%, 11.9% and 7.3% in North America, Europe and Asia Pac, respectively. As Tim mentioned, we did not experience the full impact of the pandemic on weekly velocity until the latter half of the fourth quarter in both North America and Europe. In addition, Q1 revenues across all geographies also reflected the typical seasonal impact from summer vacation.

- While the pandemic adversely impacted revenue in most of our markets, we continue to deliver strong results through our Client Programs, our Countsy and Veracity business. Revenue from our Client Programs increased by 1.3% and Countsy revenue increased by 7.4% compared to Q1 of fiscal 20. Veracity's daily revenue run-rate was up 9% compared to the prior year quarter.

- Our first quarter gross margin was 39.3%, up 10 basis points from the prior year quarter, but down 110 basis points sequentially.

- The year over year increase was primarily the result of lower client reimbursement revenue, largely offset by higher non-billable pay and unfavorable self-insured medical expense. Bill pay spread in the first quarter remained fairly consistent with Q1 of fiscal 20.

- The sequential decrease in gross margin was primarily due to lower bill pay spread and elevated self-insured medical expense. As discussed during our last earnings call, medical expense in Q4 was abnormally low due to trends and behaviors caused by COVID. As expected, medical expense returned to pre-COVID levels in Q1 as social distancing restrictions eased.

- The average hourly bill rate for the quarter was approximately $124 compared to $122 in the prior year quarter and $127 in Q4 of fiscal 20.

  Geographically, the US average bill rate held steady from prior year quarter while average bill rate in Europe improved by 7.9%. Sequentially, average bill rate decreased by 1.1% in the US and by 4% in Asia Pacific, contributing to the overall decline.

  The average pay rate for the quarter was $62 compared to $61 in prior year quarter and $63 in the prior quarter sequentially.

Now turning to SG&A and EBITDA.

- SG&A expenses for the quarter were $51.2 million compared to $57 million in the prior year quarter.
- As a result of the restructuring actions we took in North America beginning in March, we realized a reduction of $2 million in management compensation costs and $0.5 million in occupancy cost, consistent with our expectation of $10 to $12 million of annual savings. We expect to achieve additional cost savings as we continue to shrink our real estate footprint.
- Variable compensation costs decreased by $1 million.
- General business expenses were down $3.3 million due to reduced travel, reduced discretionary spend and the recovery of $1 million of legal fees in connection with a receivable collection case.
- Partially offsetting the reductions noted, we incurred planned restructuring charges of $1 million relating to employee termination in North America.
- In the end, our adjusted EBITDA in Q1 was $10.2 million or 6.9% of revenue, compared to $11.9 million, also 6.9% of revenue in the prior year quarter, reflecting the impact of significantly reduced SG&A expenses.

Turning to the other components of our financial statements –

- Income tax provision was $2 million for the first quarter, representing an effective tax rate of 46%, compared to 35% in the prior year quarter. The effective tax rate was mostly impacted by the effect of valuation allowances on lower pre-tax income. Cash tax rate for the first quarter was 33% compared to 30% in the prior year quarter.

- Our net income for the first quarter was $2.3 million or 7 cents per diluted share, compared to $4.9 million, or 15 cents per diluted share in the prior year quarter.

- In order to reflect our ongoing operating results in the earnings per share measure, we redefined the adjusted diluted EPS this quarter to exclude the impact of stock compensation, contingent consideration and restructuring charges. Prior period measures have been recast to conform to the new definition. The redefined adjusted diluted EPS for Q1 of fiscal 21 is 14 cents per share compared to 18 cents per share in the prior year quarter.

- Our balance sheet remains strong. We ended the quarter with cash and cash equivalents of $114.6 million up from $95.6 million at the end of fiscal 20. We generated $18.6 million of positive cash flow from operations in the first quarter primarily through healthy receivable collections and the deferral of payroll taxes under the CARES act. Our ability to generate positive cash flow despite COVID-related revenue headwinds reflects the variable cost nature of our business.

- Receivables at quarter end were $108 million, compared to $125 million at the end of fiscal 20. Quarterly DSO improved by 2 days to 67 in Q1, compared to 69 in Q4 of fiscal 20.

- In order to preserve cash while balancing shareholder returns, we did not make any share repurchases during the quarter. However the board of directors maintained our 14 cent per share quarterly dividend in the first quarter.

- Subsequent to quarter-end, we amended and extended our credit facility to provide more liquidity and flexibility. We repaid $20 million of our outstanding debt in September.
- In the long run, we will continue to evaluate our capital allocation strategy and expect to return cash to shareholders through dividends and share repurchases, while balancing debt repayment and the capital requirements of growing our business both organically and strategically.

I'll close with a discussion of early second quarter trends including our European restructuring plan.

- We have seen an uptick in revenue at the start of the second quarter, but still expect to experience year over year deterioration in the quarter. Weekly average revenue for the first 3 non-holiday weeks of the quarter was $11.6 million.
- As Kate mentioned, we are well underway on our restructuring initiative in Europe. The plan was approved at the beginning of September, and includes a reduction in force that is proposed to impact approximately 40% of European headcount, as well as a reduction in our real estate footprint. We expect to complete the restructuring by the end of fiscal 2021, with total employee termination costs ranging from $5.5 to $6.5 million, and real estate and other ancillary contract termination costs ranging from $2.5 to $3.5 million. Upon completion of the restructuring, we expect annual pre-tax savings of $7 to $9 million beginning in fiscal 2022.

Consistent with our approach last quarter, we will not issue any specific revenue or earnings guidance for the second fiscal quarter 21given the ongoing uncertainty as it relates to the pandemic.

I will now turn it back to Kate for some closing comments.

Kate Duchene, Chief Executive Officer:

Thank you, Jenn. Before we turn to questions, I'll share data on client continuity for Q1 FY21.

Despite the global pandemic, client continuity remains strong. During the first quarter, we served all of our top 50 clients from fiscal 2020 and 48 of the top 50 from 2019.

In addition, our top 50 clients for the quarter represented 44% of total revenues while 50% of our revenues came from 72 clients. These 72 clients have been clients of RGP on average for over 10 years. While we may not know exactly what specific projects we will work on year over year, we have become sticky in this client set because they trust us to deliver the execution element of strategic projects.

That concludes our prepared remarks and we are now happy to answer your any questions.