Resources Global Professionals

Fiscal 2020 4th 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. Alice Washington, General Counsel of Resources Connection. Ms. Washington, you may now begin.

Alice Washington, 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 fourth quarter ended May 30, 2020. By now you should have a copy of today's press release. If you need a copy and are unable to access it on our website, please call Shannon McPhee at (714) 430-6363.

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 25, 2019, 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, Alice.

Welcome to our Q4 FY20 Earnings Call. We appreciate you listening in today.

Let me start with an overview of the fourth quarter and certain highlights. Tim will then offer some operational color and Jenn will dive deeper into financial performance.

Our operating model proved resilient in the face of unprecedented economic disruption. Our revenue at $178.6 million was down 1.4% constant currency. Gross profit was $72.2 million in the quarter, a decline of 1.1% from prior year quarter, yet our gross margin of 40.4% represents an improvement of 30 basis points from prior year quarter. This is a reflection of a reduction in pass-through expense related to delivery. Adjusted EBITDA increased to $18.6 million or 10.4% of revenue, up from 9.6% in the prior year quarter.

With respect to COVID-19 impact, subsequent to the end of the fourth quarter we started to see a slight uptick in buying environment in June, – but new project signings across the board, do remain soft. Our teams have done an exceptional job of managing extensions but most new projects with new clients or new buyers within our clients' environments are still on hold or pushing out. To that point, revenue will continue to be challenged until greater clarity exists in the macro environment. Tim will provide further market trends in Q1 during his remarks.

Now, let me provide an update on our progress with our digital staffing platform or HUGO, the name we've given this tool. HUGO combines the word

"human" and the word "go" and is a perfect reflection of our brand identity. We are making good progress with our development, process redesign and integration efforts, but have been impacted by some COVID-19 related delays. We are fully committed to getting the technology and experience right, so we will not rush to market until we are ready. We will provide a more complete update as we get closer to the launch, which we believe will be prudent to hold until the macro environment gains sustainability which could be late into the calendar year in 2020 or even coming out of winter in 2021.

Following up on previous actions we took in early March to reduce costs, we now think those savings will range from $10 to $12 million and contribute meaningful impact starting in FY21. We continue to evaluate our real estate strategy with people and technology strategies and will likely accelerate our real estate contraction activities in view of current trends. With respect to Europe, the next and final phase of our restructuring initiative, our review is ongoing, with the timeline pushing out given COVID-19 and related lockdowns throughout Europe. We will provide an update on our next call.

Now, let me discuss three macro shifts that are accelerating because of COVID-19 that we believe could be beneficial to RGP. These include increased use of contingent talent, virtual or remote delivery becoming mainstream, and new client attitudes toward borderless talent. Many clients are exploring a

shift in workforce strategy toward agile or contingent workers. Staffing Industry Analysts, for example, predicts the use of contingent labor will rise in the next two years by 5%. In a June 2020 Gartner survey of more than 700 HR and Finance executives, 32% reported a wider use of contingent labor versus full-time equivalents in the post-COVID environment. In addition, clients are more willing to procure talent virtually. For knowledge workers, many clients have realized that on-premise is no longer essential to ensure quality delivery and outcomes. Clients like engaging more rapidly with virtual talent through technology and have become more open to working with talent from remote locations. We believe these trends will create additional opportunity for RGP. Keep in mind that more agile ways of working are the core of our business model. The move to virtual and borderless talent helps us manage supply and demand more efficiently, which should result in faster revenue generation and reduced turnover. We have officially entered the Now of Work – and I believe RGP is operating from a position of strength.

Finally, I will close my remarks by sharing our focus in three areas for FY21. The first is cost control. While revenue may be murky, we can and will continue to focus on improving our cost structure globally. We are committed to completing Project Strength in Europe to deliver further cost control improvements this year and continue to evaluate all parts of the business and

its structure to derive savings without disrupting the client or consultant experience.

The second focus area is building the core, including the growth of our Strategic Client and Key Account programs. We want to build on our Q4 effort that saw us increase sequential revenue in this core client base by approximately 6% on a same-day basis despite COVID. This important client set has had a CAGR of 7.4% over the past five years so we know client centricity pays off. In Q4, 300 clients spent more than $125K with RGP up from 278 in Q4 of FY19. We will focus on helping expand our services within these clients at a time when many are looking to leverage down their own professional services costs by moving beyond the Big 4. We also intend to expand to new buyers within these organizations who already trust us – like Chief Digital, Chief People and Chief Marketing Officers. As one client recently shared with me directly, you already have a "choir of champions" here – now is your opportunity to expand. For FY20, 98% of our top 50 clients procured more than one type of service or solution set. This percentage is up from 92% in FY19.

We are also committed to growing our presence in the healthcare industry. We see robust opportunity in the industry from pharma, to medical device to payor/provider. Much of the work we do for our healthcare clients is mission

critical, like revenue cycle optimization, clinical trials process redesign and optimization and supply chain transformation. These client needs align well with the capabilities of our dedicated industry group.

The third area of focus is digital expansion. This effort includes bringing HUGO to market successfully and starting to introduce a new way of engaging with RGP. It also includes expanding the go-to-market penetration for Veracity, which to remind you, is the digital transformation firm we acquired last year providing consulting services from strategy and roadmap to technical digital transformation. Digital transformation agendas will be accelerated post COVID throughout all of our target industries. Interest is growing in improving employee experiences, advancing digital workflows and automation. Thus, we will be focused on introducing Veracity more broadly in our client base this year.

There is great excitement and energy at RGP as we start this fiscal year. Certainly there remain many challenges, but RGP is a proven leader in having the people, the technology perspective and the fortitude to deliver and provide long-term cost-effective solutions for companies. It is not just us saying it – our client retention statistics underscore this point. 82% of the Top 100 clients from FY16 are still clients today and have retained us for services each and every fiscal year. Our top 25 clients contribute more than 25% of our global

revenue consistently over the past five years. While we may not know exactly how we will be engaged year after year, we remain a trusted partner to help clients execute their priority initiatives.

Before I conclude, I would like to encourage everyone to take the time to review our new Investor Relations presentation, available on the IR page of our main website. We will be posting our earnings script there as well following this call.

I will now turn the call over to Tim to offer a deeper dive into Q4 results and key takeaways.

Tim Brackney, President & Chief Operating Officer:

Thank you, Kate and good afternoon everyone. I will highlight operating trends and initiatives that impacted our results and operations for the fourth quarter and discuss early first quarter trends.

I am extremely proud of the way our Company has responded to a world afflicted by a global pandemic. We adjusted quickly to virtual delivery and were able to preserve a healthy average run rate through the quarter. We continue to engage directly, albeit virtually, with clients and prospects who are now more accustomed to this new way of working.

As Kate discussed, our clients' embracing of virtual delivery will benefit RGP as it has paved a clear shift in the way we staff engagements and execute on projects. This will enable us to unlock our talent to operate in a more borderless fashion, as proximity has become a less important consideration than in pre-Covid days.

This is a meaningful opportunity for our business, as it streamlines the matching of supply and demand, allowing us to attract and retain talent more broadly and provide a larger catalogue of skills and competencies, on an agile basis, to our clients. It also provides for flexibility in using a more modular approach to complex project execution. We believe this will be a sustainable trend that will outlive the pandemic and contribute to our business long term.

Now let me turn to our fourth quarter operations. As noted in our third quarter remarks, we saw strong weekly velocity and pipeline activity at the beginning of the fourth quarter. As we moved through the fourth quarter, we were able to maintain positive operational metrics with velocity, pipeline and activity holding steady until mid-April when we experienced some degradation in momentum. The tightening environment around new project starts and business development softened our pipeline and sales activity. This decline in run rate and pipeline beginning in the middle of the quarter stabilized by the end of May and into the new fiscal year. The impact has been particularly felt

in North America, where the overall business climate continues to be challenged by the persistency of outbreaks and the resulting uncertainty in the marketplace. Despite these headwinds, Sitrick, Veracity, and Countsy remained steady through Q4; similarly, Asia-Pacific and Europe remained steady in terms of velocity - due principally to the timing of the pandemic and resultant geographic response.

Our margins have remained strong through the course of the current quarter and deal pricing remains consistent. That said, we have adopted a more aggressive approach to pricing in response to market conditions, and will continue to be opportunistic around deal pricing and flexible in our engagement deployment in fiscal 21 as we know our clients and prospects are still engaging in crucial projects and transformation efforts.

While we continue to operate in a world of uncertainty, we know our resilience depends on our ability to control what we can. Our teams are committed to re-doubling our outreach efforts in part by exploring new ways to connect - including curating virtual learning and networking environments that allow our clients to directly interface with each other. It also means casting a wider net for talent and staying close to our people in ways we haven't done before – that is one upside of operating more virtually. An ancillary benefit has been

a decline in operating expense of ~3% during the fourth quarter as a result of pandemic-induced travel restrictions and social distancing requirements.

We continue to optimize our core business platform with a focus on go-to-market productivity, delivery effectiveness, efficient matching of supply and demand and evolving the consultant experience. The North American reorganization efforts we started in the fourth quarter were driven by these key elements and have started to yield results, although the impact of COVID is hard to detach from the operational gains.

Before I conclude my remarks, I want to provide some insight on early first quarter trends. Q1 is always a bit challenged during the summer months, and this year we must take into account the reduction in pipeline and velocity experienced at the end of Q4, as well as any added macro impact of the pandemic on our operations, the severity of which is hard to predict. This, again, has been particularly true in parts of North America as I noted above. We are buoyed by lifts in our healthcare practice, our efforts to match talent in a more borderless fashion, and a strong focus on deeper integration with Veracity in both our strategic client programs and core business. While we are encouraged by these opportunities, we understand there is real uncertainty ahead, and will remain focused on go-to-market productivity and controlling cost, both of which are paramount in the current environment.

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. As a reminder, the fourth quarter of fiscal 20 consisted of 14 weeks as compared to our typical 13-week quarters.

Starting with an overview of our fourth quarter results – As anticipated, fourth quarter revenue was significantly impacted by the COVID pandemic across most of our markets. The adverse impact of the pandemic was mostly offset by the additional week this quarter. Top line revenue for the fourth quarter of fiscal 20 was $178.6 million, a 2% decrease from the comparable quarter a year ago, and a 6.3% increase sequentially. On a constant currency basis, revenue decreased 1.4% year-over-year and increased 6.7% sequentially.

Our fourth quarter gross margin was 40.4%, up 30 basis points from the fourth quarter of fiscal 19 and 390 basis points sequentially.

SG&A expenses for the quarter, which included a restructuring charge of $5 million, were $62 million, or 34.7% of revenue compared to $56.9 million, or 31.2% of revenue last year.

Our net income for the fourth quarter was $4.1 million or 13 cents per diluted share, compared to $9.4 million, or 29 cents per diluted share in the prior year quarter. The impact of the restructuring charge on diluted EPS in the fourth quarter of fiscal 20 was 11 cents per share.

In Q4, adjusted EBITDA, which we define as EBITDA before stock compensation, contingent consideration adjustments and restructuring charges, was $18.6 million or 10.4% of revenue, up from $17.5 million, or 9.6% of revenue in the prior year quarter, reflecting the impact of favorable SGA expenses.

Now let me provide some color around our fourth quarter revenue results – Again, the fourth quarter consisted of 14 weeks. To ensure consistency, comparability and clarity of our results, we compare revenue on a same day basis, calculated by applying the number of business days in the comparable period to the current period daily revenue run rate. Please refer to our press release for additional detail on the number of business days in each comparable period.

Consolidated revenue for the fourth quarter included $6.2 million of revenue from Veracity and $2.1 million of lost revenue resulting from exiting the Nordic and Belgium markets. Excluding the impact of these events, and on a same day basis, organic revenue decreased by $18 million, or a 10% decline

compared to Q4 of fiscal 19. On a constant currency basis, organic same day revenue declined by 9.5% compared to last year.

At a geographic level, compared to Q4 of fiscal 19, organic same day revenue declined by 8.8% in North America, 12.7% in Europe and 19.5% in Asia Pac, or declines of 8.6%, 9.9% and 18.3%, respectively, on a constant currency basis.

Sequentially, consolidated same day revenue including Veracity decreased by 4% from Q3, or 3.6% on a constant currency basis. The declines within each geography were similar, ranging between 3 and 4%.

While the pandemic adversely impacted revenues in most of our markets, we had bright spots in our Dallas, San Antonio and Seattle markets. Our Countsy business also performed well given the inherently sticky nature of the managed services model.

Revenue from our largest clients continued to show strength and was largely unaffected. Same day revenue from our SCP clients increased by 9.1% compared to Q4 last year and increased 10.1% sequentially.

A final observation, despite the pandemic, our revenue from professional staffing remained strong. North America professional staffing revenue actually

increased 5.3% compared to Q4 last year and 0.4% sequentially on a same day basis.

Turning to gross margin – Gross margin for the fourth quarter was 40.4%, increasing 30 basis points from Q4 of fiscal 19, and 390 basis points sequentially. The year-over-year increase is primarily driven by the U.S. and is attributable to lower passthrough revenue from client reimbursement and favorable self-insured medical expense, contributing approximately 140 basis points of increase, partially offset by higher non-billable pay and a slight decline in bill pay ratio aggregating to roughly 100 basis points.

The sequential increase in gross margin is attributable to lower passthrough revenue from client reimbursement, lower consultant holiday pay and payroll tax expense, favorable self-insured medical expense, and a slight improvement in bill-pay ratio.

The average hourly bill rate for the quarter was approximately $127 dollars compared to $124 in the prior year quarter and $123 sequentially.

The average bill rates in the US and Europe improved by 0.7% and 1.3% compared to the prior year quarter, respectively. The gains were partially offset by a decline in average bill rate in Asia Pac. Sequentially, average bill rate increased by 2.1% in the US and 4.2% in Asia Pac.

The average pay rate for the fourth quarter of fiscal 20 was $63 dollars compared to $62 in the fourth quarter of fiscal 19 and $63 in the third quarter of fiscal 20.

As a reminder, these hourly rates are derived based on prevailing exchange rates during each given period.

Now, looking at other components of our fourth quarter financial results – SG&A expenses were $62 million, or 34.7% of revenue.

Included in the fourth quarter SGA was $5 million of charges related to restructuring activities and $1.9 million of expense due to changes in earnout estimate relating to the Veracity acquisition. Excluding these charges, SGA was $55.1 million, or 30.9% of revenue in the fourth quarter.

General business expenses were down $1.6 million and $1.3 million compared to last year and sequential quarter, respectively, due to reduced travel and other discretionary spend. In addition, we experienced favorable trends in our self-insured medical program as a result of lower usage during the pandemic, resulting in lower incurred claim costs.

We executed our restructuring plan in North America by reducing both headcount and real estate footprint. We incurred $3.9 million in employee termination costs and $1.1 million in costs related to lease terminations and

fixed asset write-off. We expect to realize additional benefit from the headcount reduction beginning in fiscal 21. As we gain more visibility into the full impact of the pandemic on our business, we intend to reinvest a limited portion of these savings over time into digital capabilities and to drive forward certain growth initiatives in core markets.

With respect to the real estate plan, to date we have either exited or sublet approximately 50% of the planned locations. We will continue to execute according to our plan while exploring the virtual model for additional markets in which we operate. While there are no guarantees, we see the potential for meaningful savings over time.

Turning to the other components of our financial statements – Income tax provision was $2.9 million for the fourth quarter, representing an effective tax rate of 42%. The effective tax rate was mostly impacted by lower pre-tax income and increase in valuation allowance.

Effective tax rate on a full year basis was 19.7% compared to 34.4% in fiscal 19. The decrease is primarily due to the US tax deduction the Company took in Q3 of fiscal 20, related to the worthless stock loss in our investments in foreign entities. Cash tax rate for fiscal 20 was 11% compared to 31% in fiscal 19.

Now let me turn to our balance sheet and liquidity – In addition to cost containment efforts, the other primary area of focus in the fourth quarter was prudent management of our cash flow and liquidity.

We ended the fiscal year with cash and cash equivalents of $95.6 million compared to $35.9 million at the end of Q3. We took a proactive measure in March to add substantial liquidity when we borrowed $39 million under our Credit Facility. We generated an additional $27.9 million of positive cash flow from operations in the fourth quarter.

Receivables at quarter end were $125 million, compared to $133.3 million at the end of fiscal 19.

Days of revenue outstanding were approximately 65 days in Q4, an improvement of 2 days from prior year and 3 days from the third quarter of fiscal 20.

To date, we have not experienced much deterioration in our receivables due to COVID-19. We implemented protocols to review and grant credit extensions or changes in payment terms. The quality of our receivables remains strong. Nonetheless, as the pandemic continues to persist, impacting our clients' liquidity positions, we may experience a more adverse impact on the quality of our receivables.

Capital expenditures were $2.3 million for the full fiscal year. In order to support the growth of our business and improve our operating leverage, we expect to invest in our system infrastructure in fiscal 21.

In order to preserve cash while balancing shareholder returns, we did not make any share repurchases during the quarter. The board of directors maintained our quarterly dividend in the fourth quarter.

In the long term, 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.

Now turning to our first quarter fiscal 21 trends – We have seen some stabilization at the start of the quarter, but still expect year over year deterioration in revenue in the first quarter, especially if a resurgence of COVID causes the US economy to shut down once again. Weekly average revenue for the first 5 non-holiday weeks of the quarter was $11.5 million.

Our self-insured medical program could experience an increase in future costs as employees resume doctor visits and procure necessary medical treatment, which could have a material impact on gross margin and operating costs.

Consistent with our approach to the fourth quarter of fiscal 20, we will not issue any specific revenue or earnings guidance for the first quarter of fiscal 21 given the ongoing uncertainty as it relates to the pandemic.

Before I conclude my remarks, I would like to remind everyone again to view the refreshed investor relations presentation we released this quarter. It is available on the Investor Relations page of our main website.

We will now open the call up for questions.