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Zacks Small-Cap Research

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Mastech Digital (NYSE Amer: MHH)

Mastech Acquires AmberLeaf Partners for $14 Million to Add to Data & Analytics Capabilities

Based on an EV to sales of 2.1xs, we believe MHH stock could be worth $32.76 per share.

Current Price (09/30/20)	$18.01
Valuation	**$32.76**

OUTLOOK

Mastech Digital, based outside Pittsburgh, PA is an IT staffing business with a growing data and analytics consulting and project management service serving blue chip customers in the US. The data and analytics business, Mastech InfoTrellis, was 14% of sales this quarter and its run rate grew from $26.6 million to $27.1 million, despite the pandemic delaying projects. The acquisition of AmberLeaf will add another $11 million to that run rate. We believe that overall business has begun to return to normal and the company's austerity has resulted in higher than normal profits near term.

SUMMARY DATA

52-Week High	**$28.67**
52-Week Low	**$5.68**
One-Year Return (%)	**206**
Beta	**0.5**
Average Daily Volume (sh)	**21,811**
Shares Outstanding (mil)	**11.3**
Market Capitalization ($mil)	**$205**
Short Interest Ratio (days)	**1.8**
Institutional Ownership (%)	**16**
Insider Ownership (%)	**63**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**12.3**
Earnings Per Share (%)	**20.3**
Dividend (%)	**N/A**
P/E using TTM EPS	**17.2**
P/E using 2020 Estimate	**16.1**
P/E using 2021 Estimate	**13.6**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**IT Services**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2018	43 A	45 A	44 A	45 A	177 A
2019	45 A	48 A	50 A	50 A	194 A
2020	50 A	48 A	48 E	55 E	201 E
2021					247 E

Non-GAAP Earnings Per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2018	$0.18 A	$0.21 A	$0.20 A	$0.16 A	$0.74 A
2019	$0.15 A	$0.20 A	$0.23 A	$0.26 A	$0.82 A
2020	$0.23 A	$0.33 A	$0.28 E	$0.30 E	$1.12 E
2021					$1.32 E

Zacks Projected EPS Growth Rate - Next 5 Years % **15**

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WHAT'S NEW

Mastech Digital Acquires AmberLeaf Partners for $14 Million

Today Mastech Digital announced the acquisition of AmberLeaf Partners, Inc. for $14.0 million. Of that, $9.5 million was paid in cash at closing, and up to $4.5 million in deferred payments could be paid over the next two years. The company has approximately $11 million in sales, is profitable, and cash flow positive. The deferred payments are contingent upon the acquired business achieving specific financial targets during the two years following the closing of the acquisition. AmberLeaf is a consulting company based in Chicago with approximately 40 employees and 40 to 50 clients. It provides managed services for companies for cloud-based applications including sales, marketing, and customer service. AmberLeaf's client base in general is comprised of companies smaller than Mastech's current data and analytics business usually services. AmberLeaf provides services that are typically sold to a marketing manager who wants actionable recommendations from its data and may not have the resources to do this analysis in house. This complements Mastech's D&A business, which sells to IT managers implementing data analysis systems. Like Mastech, AmberLeaf also sells on a contract basis: either time and materials or monthly recurring flat fee. While the company has not been growing Mastech believes with its resources and sales and marketing infrastructure, it can grow revenues at AmberLeaf and even cross sell to its current clients.

As a result of this acquisition that closes today, we are increasing our revenue and earnings estimates for Q4 2020 and beyond. We are now estimating Q4 revenues of $54.9 million in Q4 and a non-GAAP EPS of $0.30. **Our 2021 estimate is raised to $247 million, up 23% year over year, with a non-GAAP EPS of $1.32.** Business at Mastech continues to recover, although slowly on the staffing side. We believe Q2 was the low point for billable consultants and expect the number to continue to increase.

Mastech is funding this acquisition from current resources but to add even more cushion to available cash, Mastech revised its credit facility with PNC Bank to increase its term loan facility by approximately $10 million to $17.5 million and increase its revolving loan facility to $30 million up from $22.5 million.

KEY POINTS

- Mastech Digital had historically been an IT staffing company, but it entered the data and analytics business in 2017 with its purchase of InfoTrellis. This business is higher margin and faster growing than IT staffing and is becoming an increasingly bigger part of total sales. This math should lead to accelerating earnings growth as well as a higher valuation for the stock.
- Mastech plans to augment its internal growth with acquisitions in the data and analytics space to expand its capabilities. It had been paying off debt through internally generated cash flow, which left it with increased debt capacity for asset purchases as well as cash to expand internationally as shown by its purchase of AmberLeaf.
- The economy continues to rebound from the pandemic and the demand for IT workers continues to increase. The data and analytics business in particular has continued to show healthy demand.
- MHH is trading at 0.9 times enterprise value to 2021 estimated sales. We believe by next year the stock price could move near a more fairly valued 2.1 times or $32.76.

OVERVIEW

Mastech Digital is a minority-owned IT services company headquartered in Moon Township, PA with offices in the US, Canada and India. It has domestic sales offices in: Chicago; Boston; Orlando; Tampa; Dallas; Atlanta; Houston; Freemont, CA; and Toronto, in addition to its headquarters near Pittsburgh. Internationally, the company has a sales presence in Singapore; Ireland and in the UK; and it recruits and provides IT outsourcing through its locations in Noida and Chennai, India. The company currently has approximately 1,100 North American employees and 400 employees offshore, in addition to over 180 subcontracted professionals. Originally, it was the IT staffing business of iGATE Capital Corp., a public company that was sold to Capgemini in 2015 for $4+ billion in cash. Mastech Digital had been previously spun off as a separate public company from iGATE in 2008. Since then it has also become a consultant, project manager and VAR in the data analytics, data management and big data through its acquisition of InfoTrellis on July 13, 2017 and of AmberLeaf on October 1, 2020. It reports earnings of these two segments. IT staffing is still the largest part of the company but the smaller, faster growing, and higher margin, data and analytics business is an increasing percent of total revenues. This dynamic should result in continued accelerating earnings growth in 2021, and this growth could result in an expansion of the stock's PE ratio.

VALUATION

The pandemic has caused quite a divergence in prospects and valuations for staffing companies based on their vertical markets. Those that depend on a physical presence, health care, manufacturing, warehousing, and general office staff have been severely hurt, while those that focus on IT have thrived as they easily can have staff work remotely. If we take those focused on the tech vertical we see and average of 2.1 times EV to sales. These companies also enjoy higher EBITDA margins. Using that average multiple and applying it to Mastech's forecasted revenues the stock is worth $32.76.

Company	Ticker	Calendar Revenue 2021E	Calendar Revenue 2020E	LTM	EBIDTA Margin	EV/Sales 2021E	EV/Sales 2020E	EV/Sales LTM	Included in Average?	Enterprise Value
Accenture	ACN	46,800	44,500	44,550	16%	3.0	3.2	3.2	y	140,700
Cognizant	CTSH	17,290	16,530	16,760	20%	2.1	2.2	2.2	y	36,600
Computer Task Group	CTG	368	353	373	3%	0.2	0.2	0.2	y	73
Infosys	INFY	13,800	12,800	12,770	24%	4.1	4.5	4.5	y	57,000
Kforce Inc.	KFRC	1,380	1,380	1,360	6%	0.6	0.6	0.6	y	774
Wipro	WIT	8,640	8,160	8,170	24%	2.3	2.5	2.5	y	20,260
Average					15.6%	2.1	2.2	2.2		6,365

	Projected Revenue 2021E	Projected Revenue 2020E	Projected Revenue TTM	EV/Sales 2021E	EV/Sales 2020E	EV/Sales TTM	Valuation Range Low	Valuation Range High
	235	198	151	2.1	2.2	2.2	327	431
YoY growth								

Conclusion of Enterprise Value	**$379,038,607**
Market Value	**$369,273,607**
Fully diluted shares	11,271,000
Price per Share	**$32.76**

RISKS

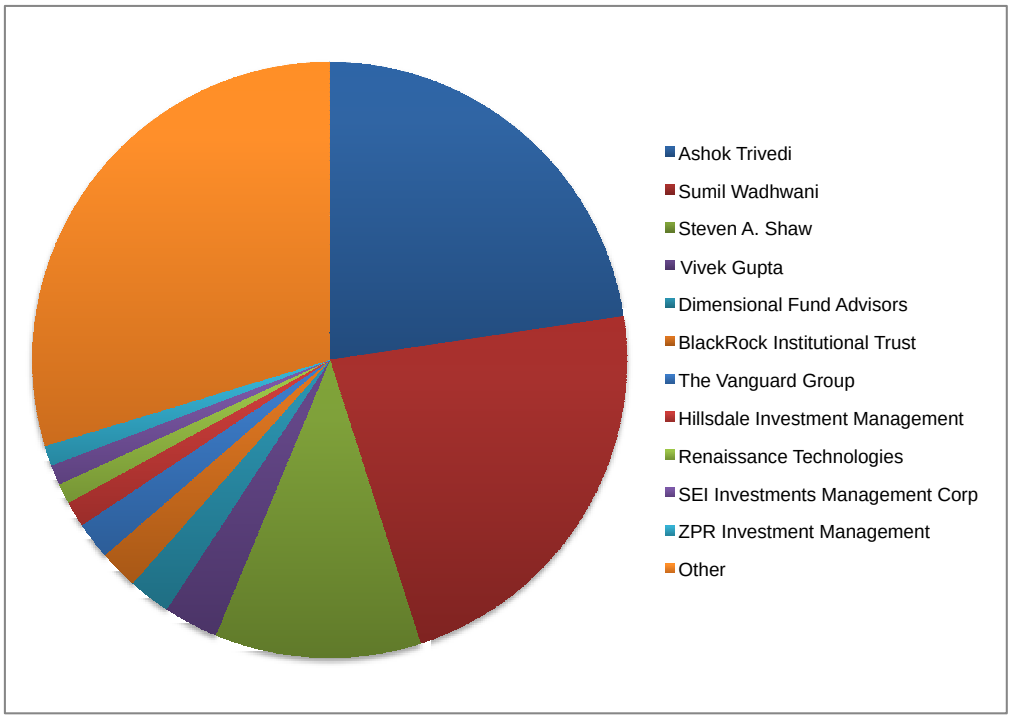
- The company is subject to the business cycle and tends to do better when the economy is robust or at the end of a recession when companies are reluctant to bring on full time hires. The current pandemic, which has resulted in business interruptions, makes it difficult to gage the current business climate both short and long term.

- The company is almost entirely dependent on the US market in the IT staffing segment.

- The top ten clients represent approximately 45% of sales with CGI being over 11.3%.

- Any regulatory changes regarding H-1B visas could eventually trickle down to Mastech's pool of potential consultants; approximately 40% of its employee base is sourced from those currently holding these visas. Although there is talk about changes to visa grants for new entries into the US, Mastech sources its workforce base from those that already have the appropriate visas. A greater acceptance of remote working could decrease this risk.

OWNERSHIP



Source: Zacks Investment Research

INCOME STATEMENT

	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020E	Q4 2020E				
	31-Mar	30-Jun	30-Sep	31-Dec	31-Mar	30-Jun	30-Sep	31-Dec	2018	2019	2020E	2021E
Billable consultants	1,116	1,113	1,197	1,167	1,100	1,035	1,197	1,200	1,100	1,165	900	1,500
Average bill rate per hour	74.56	74.75	74.60	NA	NA	NA			73.01	74.97	73.00	74.70
IT Staffing Services	39,431	41,818	42,463	43,199	43,065	40,811	40,500	44,000	153,361	166,911	168,376	198,000
Yr-to-yr Growth	7%	8%	10%	10%	9%	-2%	-5%	2%	11%	9%	1%	18%
IT Staffing Gross Margin	8,202	8,991	9,087	9,245	9,259	9,142	8,910	9,680	32,326	35,524	36,991	43,560
Gross Margin %	21%	21.5%	21.4%	21.4%	21.5%	22.4%	22.0%	22.0%	21.1%	21.3%	22.0%	22.0%
Data & Analytics Services	5,768	6,654	7,080	7,161	7,360	6,772	7,100	10,900	23,803	26,663	32,132	48,600
Yr-to-yr Growth	-12%	9%	22%	34%	28%	2%	0%	52%	159%	12%	21%	51%
Data & Analytics Gross Margin	2,624	3,067	3,236	3,516	3,467	3,535	3,710	5,123	10,477	12,444	15,835	23,085
Gross Margin %	46%	46.1%	46%	49%	47%	52%	52%	47%	44.0%	46.7%	49.3%	48%
Revenue	**$45,199**	**$48,472**	**$49,543**	**$50,360**	**$50,425**	**$47,583**	**$47,600**	**$54,900**	**$177,164**	**$193,574**	**$200,508**	**$246,600**
Yr-to-yr Growth	4%	8%	12%	13%	12%	-2%	-4%	9%	20%	9.3%	3.6%	23.0%
Cost of revenue	34,364	36,418	37,214	37,597	37,706	34,927	34,980	40,097	134,636	145,593	147,710	179,955
Gross profit	10,835	12,054	12,329	12,763	12,719	12,656	12,620	14,803	42,528	47,981	52,798	66,645
Gross Margin %	24.0%	24.9%	24.9%	24.5%	25.2%	26.6%	26.5%	27.0%	24.0%	24.8%	26.3%	27.0%
SG&A	8,965	9,544	9,259	9,295	10,243	9,042	9,500	11,300	32,221	37,063	40,085	50,000
Impairment of goodwill	0	0	0	0	0	0	0	0	9,738	0	0	0
Revaluation of contingent consideration liabilty	0	(6,069)	0	0	0	0	0	0	(11,056)	(6,069)	0	0
Total operating expenses	8,965	3,475	9,259	9,295	10,243	9,042	9,500	11,300	30,903	30,994	40,085	50,000
Operating income:	1,870	8,579	3,070	3,468	2,476	3,614	3,120	3,503	11,625	16,987	12,713	16,645
Operating margin	4.1%	17.7%	6.2%	6.9%	4.9%	7.6%	6.6%	6.4%	6.6%	8.8%	6.3%	6.7%
Other income:												
Interest income	(539)	(468)	(413)	NA	NA	NA	NA	NA	(2,171)	NA	(583)	(400)
Other income	(15)	(39)	33	NA	NA	NA	NA	NA	(40)	NA	-	-
Total other income	(554)	(507)	(380)	(327)	(226)	(157)	(100)	(100)	(2,211)	(1,768)	(583)	(400)
Income before income taxes	1,316	8,072	2,690	3,141	2,250	3,457	3,020	3,403	9,414	15,219	12,130	16,245
Pretax Margin	2.9%	16.7%	5.4%	6.2%	4.5%	7.3%	6.3%	6.2%	5.3%	7.9%	6.0%	6.6%
Income taxes	352	2,114	741	867	381	488	740	834	2,723	4,074	2,443	4,386
Tax rate	27%	26%	28%	28%	17%	14%	25%	25%	28.9%	26.8%	20%	26%
Net income	964	5,958	1,949	2,274	1,869	2,969	2,280	2,569	6,691	11,145	9,687	11,859
Yr-over-Yr	-30%	112%	20%	160%	94%	-50%	17%	13%	312%	67%	-13%	22%
Stk based compensation	236	267	263	170	456	612	612	612	470	936	1,100	1,100
One-time expenses	431	(4,046)	338	(224)	377	328	424	424	1,088	(5,518)	1,553	1,700
Non-GAAP Income	1,631	2,179	2,550	2,891	2,702	3,909	3,316	3,605	8,249	9,251	12,340	14,659
Yr-over-Yr	-17%	-5%	16%	63%	66%	79%	30%	25%	79%	12.1%	33%	19%
Net income per share:												
Primary EPS	0.09	0.54	0.18	0.21	0.17	0.26	0.20	0.23	0.61	1.01	0.88	1.07
Diluted EPS	0.09	0.53	0.17	0.20	0.16	0.25	0.19	0.21	0.60	0.99	0.88	1.07
Diluted Non-GAAP EPS	0.15	0.20	0.23	0.26	0.23	0.33	0.28	0.30	0.74	0.82	1.12	1.32
	-18%	-6%	16%	61%	59%	68%	21%	17%	60%	11%	36%	18%
Shares												
Basic	10,998	11,022	11,039	11,049	11,127	11,271	11,379	11,389	10,950	11,029	$11,049	$11,100
Yr-over-Yr	0.7%	0.9%	0.7%	0.5%	1.2%	2.3%	3.1%	3.1%	10.3%	1%	0%	0%
Diluted	11,218	11,164	11,205	11,314	11,675	11,948	11,998	12,048	11,161	11,232	11,050	11,101
Yr-over-Yr	1.4%	0.2%	-0.1%	1.1%	4.1%	7.0%	7.1%	6.5%	11.6%	1%	-2%	0%

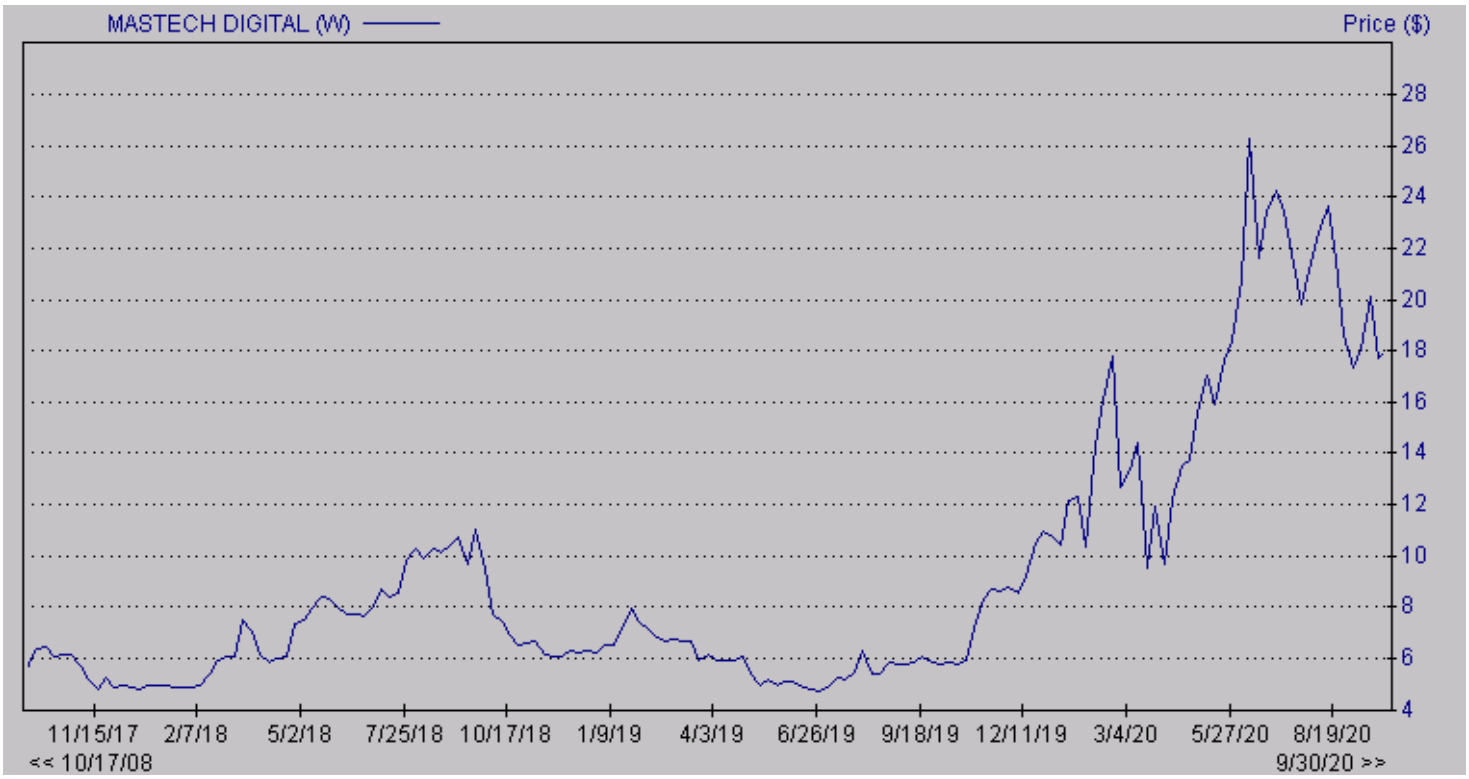
BALANCE SHEET

	Jun. 30, 2020	Mar. 31, 2020	Qtr-Qtr % Growth	Jun. 30, 2019	Yr-Yr % Growth
Current assets:					
Cash and equivalents	**$ 4,743**	**$ 2,575**	84.2%	**$ 3,869**	66.3%
Accounts receivable, net	31,208	33,596	-7.1%	25,730	16.0%
Unbilled receivables	0	0	NM	10,061	-100.0%
Prepaid expenses & other curr assets	1,224	1,036	18.1%	1,349	-11.5%
Total current assets	37,175	37,207	-0.1%	41,009	-11.1%
Equipment, software and leasehold net	2,230	2,393	-6.8%	1,730	-2.1%
Right-of-use assets	3,978	4,348	-8.5%	4,980	-18.4%
Non-current deposits	385	388	-0.8%	447	-26.9%
Goodwill, net	26,106	26,106	0.0%	26,106	0.0%
Intangible assets, net	18,708	19,377	-3.5%	21,394	-12.2%
Total assets	88,582	89,819	-1.4%	96,374	-9.0%
Current liabilities:					
Current portion of long-term debt, net	**4,575**	**8,537**	-46.4%	**4,575**	86.6%
Acconts payable	3,073	3,440	-10.7%	3,909	-12.5%
Accrued payroll and related costs	9,616	9,456	1.7%	10,088	24.2%
Current portion of operating lease liability	1,295	1,392	-7.0%	1,339	1.8%
Other accrued liabilities	1,554	764	103.4%	1,097	-50.6%
Deferred revenue	0	0	0.0%	174	-100.0%
Total current liabilities	20,113	23,589	-14.7%	21,182	-7.3%
Long-term debt, net	**9,933**	**13,358**	-25.6%	**28,366**	-60.3%
Lease liability	2,760	3,019	-8.6%	3,736	-23.8%
Long term accrued income taxes	185	185	0.0%	204	-9.3%
Long term payroll tax liability	1,495	0	NM	0	NM
Long term deferred income taxes	837	843	-0.7%	1,157	NM
Total liabilities	35,323	40,994	-13.8%	54,645	-35.2%
Stockholders' equity					
Common stock	130	128	1.6%	127	1.6%
Additional paid-in capital	24,432	22,950	6.5%	21,437	8.9%
Retained earnings	33,597	30,628	9.7%	24,536	64.9%
Accumulated other comp loss	(713)	(694)	2.7%	(184)	362.7%
Treasury stock, at cost	(4,187)	(4,187)	0.0%	(4,187)	0.3%
Total stockholders' equity	53,259	48,825	9.1%	41,729	37.7%
Total liabilities and stockholders' equity	88,582	89,819	-1.4%	96,374	-9.0%
Current and quick ratio	1.8	1.6	17.2%	1.9	-4.1%
Working Capital	17,062	13,618	25.3%	19,827	-17.0%
Net cash	4,743	2,575	84.2%	3,869	66.3%
Debt	14,508	21,895	-33.7%	32,941	-42.7%
Debt/TA	16%	24%	-32.8%	34%	-37.1%

CASH FLOWS

	Year 2018	3 Mo Ended Mar 31, 2019	3 Mo Ended Jun 30, 2019	3 Mo Ended Sep 30, 2019	3 Mo Ended Dec 31, 2019	Year 2019	3 Mo Ended Mar 31, 2020	3 Mo Ended Jun 30, 2020
Cash flows from operating activities:								
Net income	6,691	964	5,958	1,949	2,274	11,145	1,869	2,959
Adjustments to reconcile net income to net cash provided by operating activities:								
Depreciation and amortization	3,182	839	869	869	857	3,434	873	868
Bad debt expense	10	-	30	50	-	80	-	-
Interest amortization of deferred financing costs	100	26	26	26	26	104	26	26
Stock-based compensation	470	236	267	263	170	936	456	612
Deferred income taxes, net	171	(95)	1,549	(75)	(57)	1,322	(182)	(6)
Impairment of goodwill	9,738	-	-	-	-	-	-	-
Reevaluation of contingent consideration liability	(11,056)	-	(6,069)	-	-	(6,069)	-	-
Loss on disposition of fixed assets	7	-	-	-	-	-	2	-
Long term accrued income taxes	136	-	-	-	(19)	(19)	-	-
Operating lease assets and liabilities, net	-	-	95	5	-	100	(37)	14
Change in operating assets and liabilities:								
Accounts receivable & unbilled receivables	(7,428)	(1,051)	3,310	781	2,608	5,648	(1,244)	2,388
Prepaid expenses and other current assets	283	110	(248)	(52)	(196)	(386)	492	(169)
Accounts payable	(901)	(196)	(22)	450	(332)	(100)	(587)	(367)
Accrued payroll	(1,241)	(112)	2,472	(260)	(1,926)	174	1,554	1,655
Other accrued liabilities	(461)	327	(448)	232	(375)	(264)	(276)	668
Deferred revenues	(172)	80	(164)	72	(9)	(21)	(151)	122
Net cash used by operating activities	(471)	1,128	7,625	4,310	3,021	16,084	2,795	8,770
Cash flows from Investing activities:								
(Payment for) recovery of non-current deposits	(285)	9	84	37	5	135	17	3
Capital expenditures	(771)	(404)	(190)	(292)	(128)	(1,014)	(119)	(36)
Net cash used in investing activities	(1,056)	(395)	(106)	(255)	(123)	(879)	(102)	(33)
Cash flows from Financing activities:								
Borrowings on revolving credit facility, net	4,526	656	(4,183)	(4,701)	4,252	(3,976)	(2,244)	(2,307)
(Repayments) on term loan facility	(4,003)	(1,144)	(1,144)	(1,144)	(6,143)	(9,575)	(1,144)	(5,106)
Proceeds from the issuance of common shares	-		106	-	62	168	-	107
Payment of deferred financing costs	(71)	-	-	-	-	-	-	-
Purchase of treasury stock	(20)		(13)	-	-	(13)	-	-
Proceeds from the exericise of stock options	118	-	-	-	7	7	556	765
Net cash provided by financing activities	550	(488)	(5,234)	(5,845)	(1,822)	(13,389)	(2,832)	(6,541)
Effect of exchange rate changes of cash	(207)	9	36	(116)	(58)	(129)	(267)	(38)
Net change - cash	(1,184)	254	2,321	(1,906)	1,018	1,687	(406)	2,168
Cash, beginning of quarter	2,478	1,294	1,548	3,869	1,963	1,294	2,981	2,575
Cash, end of period	1,294	1,548	3,869	1,963	2,981	2,981	2,575	4,743
Supplemental information:								
Interest paid	2,060	-	-	-	-	1,780	-	-
Income taxes paid	2,031	-	-	-	-	2,634	-	-
Cash Flow	9,449	1,970	2,725	3,087	3,251	11,033	3,007	4,473
Free cash flow	8,678	1,566	2,535	2,795	3,123	10,019	2,888	4,437

HISTORICAL STOCK PRICE



Source: Zacks Investment Research

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