Mastech Holdings, Inc.
Form 10-Q
November 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2012

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 001-34099

MASTECH HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	**26-2753540**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1000 Commerce Drive, Suite 500 Pittsburgh, PA	**15275**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (412) 787-2100

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was require to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.:

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares of the registrant s Common Stock, par value $.01 per share, outstanding as of October 31, 2012 was 3,190,664.

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MASTECH HOLDINGS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2012

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MASTECH HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues	$ 25,629	$ 23,489	$ 75,395	$ 65,505
Cost of revenues	20,744	18,840	61,221	52,574
Gross profit	4,885	4,649	14,174	12,931
Selling, general and administrative expenses	3,945	3,921	11,867	11,516
Income from operations	940	728	2,307	1,415
Interest income (expense), net	(17)	(9)	(50)	(21)
Other income (expense), net	52	(9)	29	(11)
Income before income taxes	975	710	2,286	1,383
Income tax expense	374	269	875	523
Net income	$ 601	$ 441	$ 1,411	$ 860
Earnings per share:				
Basic	$ .19	$ .12	$ .43	$ .23
Diluted	$ .18	$ .12	$ .42	$ .23
Weighted average common shares outstanding:				
Basic	3,176	3,657	3,271	3,673
Diluted	3,277	3,755	3,376	3,786

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements

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MASTECH HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
Net income	$ 601	$ 441	$ 1,411	$ 860
Other comprehensive income (loss):				
Net unrealized gain on cash flow hedges, net of tax (expense) of ($28) and ($30) in 2012	43		45	
Total other comprehensive income	$ 43	$	$ 45	$
Total comprehensive income	$ 644	$ 441	$ 1,456	$ 860

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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MASTECH HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share and per share data)

(Unaudited)

	September 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,253	$ 5,755
Accounts receivable, net of allowance for uncollectible accounts of $305 in 2012 and 2011	9,301	10,430
Unbilled receivables	5,090	1,495
Prepaid and other current assets	1,324	1,046
Deferred income taxes	21	177
Total current assets	18,989	18,903
Equipment, enterprise software, and leasehold improvements, at cost:		
Equipment	1,764	1,683
Enterprise software	720	675
Leasehold improvements	555	555
	3,039	2,913
Less accumulated depreciation	(2,774)	(2,640)
Net equipment, enterprise software, and leasehold improvements	265	273
Intangible assets, net	31	53
Deferred financing costs, net	54	74
Goodwill	405	405
Deferred income taxes	205	80
Total assets	$ 19,949	$ 19,788
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,907	$ 2,309
Accrued payroll and related costs	5,363	4,002
Other accrued liabilities	334	324
Deferred revenue	94	106
Total current liabilities	7,698	6,741
Total liabilities	7,698	6,741
Commitments and contingent liabilities (Note 5)		
Shareholders equity:		
Preferred Stock, no par value; 20,000,000 shares authorized; none outstanding		
Common stock, par value $.01; 100,000,000 shares authorized and 3,759,713 shares issued as of September 30, 2012 and 3,711,988 shares issued as of December 31, 2011	38	37
Additional paid-in-capital	10,383	10,114
Retained earnings	4,873	3,462

Accumulated other comprehensive income		45		
Treasury stock, at cost; 578,912 shares as of September 30, 2012 and 142,886 as of December 31, 2011		(3,088)		(566)
Total shareholders equity		12,251		13,047
Total liabilities and shareholders equity	$	19,949	$	19,788

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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MASTECH HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	Nine Months ended September 30, 2012	Nine Months ended September 30, 2011
OPERATING ACTIVITIES:		
Net income	$ 1,411	$ 860
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Depreciation and amortization	156	134
Interest amortization of deferred financing costs	20	
Bad debt (credit) expense		(50)
Stock-based compensation expense	161	182
Deferred income taxes, net	31	79
Loss in unconsolidated affiliate		5
Gain on derivative contract	(25)	
Working capital items:		
Accounts receivable and unbilled receivables	(2,466)	(2,603)
Prepaid and other current assets	(208)	162
Accounts payable	(402)	(682)
Accrued payroll and related costs	1,361	1,724
Other accrued liabilities	10	69
Deferred revenue	(12)	(38)
Net cash flows provided by (used in) operating activities	37	(158)
INVESTING ACTIVITIES:		
Capital expenditures	(126)	(102)
Net cash flows (used in) investing activities	(126)	(102)
FINANCING ACTIVITIES:		
Payment of deferred financing costs		(83)
Purchase of treasury stock and other equity securities	(2,522)	(369)
Proceeds from the exercise of stock options	67	22
Increase (reduction) in excess tax benefits related to stock options, net	42	(30)
Net cash flows (used in) financing activities	(2,413)	(460)
Net change in cash and cash equivalents	(2,502)	(720)
Cash and cash equivalents, beginning of period	5,755	6,334
Cash and cash equivalents, end of period	$ 3,253	$ 5,614

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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MASTECH HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2012 AND 2011

(Unaudited)

1. Description of Business and Basis of Presentation:

References in this Quarterly Report on 10-Q to we , our , Mastech or the Company refer collectively to Mastech Holdings, Inc. and its wholly-owned operating subsidiaries, which are included in these Condensed Consolidated Financial Statements.

Description of Business

We are a provider of IT and specialized healthcare staffing services. Our IT staffing business combines technical expertise with business process experience to deliver a broad range of services within business intelligence / data warehousing; web services; enterprise resource planning & customer resource management; and eBusiness solutions. We work with businesses and institutions with significant IT spending and recurring staffing needs. We also support smaller organizations with their project focused temporary IT staffing requirements. Our services span a broad range of industry verticals including: automotive; consumer products; education; financial services; government; healthcare; manufacturing; retail; technology; telecommunications; transportation; and utilities. Our healthcare staffing business provides specialized healthcare professionals, including surgical nurses and physical therapists to hospitals and other healthcare facilities.

Basis of Presentation

The accompanying Unaudited Condensed Consolidated Financial Statements (the Financial Statements) have been prepared by management in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and applicable rules and regulations of the Securities and Exchange Commission (the SEC). Accordingly, they do not include all of the information and disclosures required by U.S. GAAP for complete consolidated financial statements. In the opinion of management, all adjustments, consisting principally of normal recurring adjustments, considered necessary for a fair presentation have been included. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from these estimates. These financial statements should be read in conjunction with the Company s audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2011, filed with the SEC on March 23, 2012. Additionally, our operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that can be expected for the year ending December 31, 2012 or for any other period.

Principles of Consolidation

The Condensed Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation. The Company utilizes the equity method of accounting, as prescribed by The Accounting Standards Codification (ASC) Topic 323 The Equity Method of Accounting for Investments in Common Stock , when it is able to exercise significant management influence over the entity s operations, which generally occurs when Mastech has an ownership interest of between 20% and 50% in an entity. For investments in which the Company does not exercise significant management influence, generally when Mastech has an ownership interest of less than 20%, the Company utilizes the cost method of accounting.

Segment Reporting

The Company, which aggregates its IT and healthcare operating segments based on the nature of services, has one reportable segment in accordance with ASC Topic 280 Disclosures About Segments of an Enterprise and Related Information .

2. Significant Accounting Policies:

Derivative Instruments and Hedging Activities

The Company is exposed to foreign currency risks as a result of its Indian-based global recruitment centers. During 2012, the Company s expenditures in Indian rupees in support of these operations have increased significantly. Accordingly, to mitigate and manage the risk of changes in foreign currency exchange rates, the Company entered into foreign currency forward contracts in June 2012. These forward contracts have been designated as cash flow hedging instruments and qualified as effective hedges at inception under ASC Topic 815, *Derivatives and Hedging* . The Company does not enter into derivative contracts for speculative purposes.

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All derivatives are recognized on the balance sheet at fair value. The effective portion of the changes in fair value on these instruments are recorded in other comprehensive income (loss) and are reclassified into the Consolidated Statement of Operations on the same line item and in the same period in which the underlying hedge transactions affects earnings. Changes in the fair value of these instruments deemed ineffective are recognized in the Consolidated Statement of Operations as foreign exchange gains (losses).

With respect to derivatives designated as hedges, the Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking such transaction. The Company evaluates hedge effectiveness at the time a contract is entered into and on an ongoing basis. If a contract is deemed ineffective, the change in the fair value of the derivative is recorded in the Consolidated Statement of Operations as foreign exchange gains (losses).

Other Significant Accounting Policies

The Company s other significant accounting policies are described in Note 1. Significant Accounting Policies of the notes to our audited Consolidated Financial Statements, included in our 2011 Annual Report on Form 10-K.

3. Goodwill

As of September 30, 2012, the Company had $405,000 of goodwill recorded on its balance sheet related to the January 2, 2010 acquisition of Curastat, Inc. There was no activity in our goodwill account during the three and nine months ended September 30, 2012 and September 30, 2011.

4. Intangible Assets

Intangible assets consist of customer relationships, trade name and non-compete covenants related to the acquisition of Curastat, Inc. Intangible assets are amortized on a straight-line basis over their estimated useful lives, which range from 2 to 5 years. Intangible assets were comprised of the following as of September 30, 2012:

	As of September 30, 2012		
(in thousands)	**Gross Carrying Value**	**Accumulated Amortization**	**Net Carrying Value**
Customer relationships	$ 60	$ 33	$ 27
Trade name	50	46	4
Non-compete covenants	40	40	
Total intangible assets	$ 150	$ 119	$ 31

Amortization expense for the nine months ended September 30, 2012 and 2011 was $22,000 and $30,000, respectively, and is included in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

5. Commitments and Contingencies

Lease Commitments

The Company rents certain office space and equipment under non-cancelable leases which provides for future minimum rental payments. Total lease commitments have not materially changed from the amounts disclosed in the Company s 2011 Annual Report on Form 10-K.

Contingencies

In the ordinary course of our business, the Company is involved in a number of lawsuits and administrative proceedings. While uncertainties are inherent in the final outcome of these matters, the Company s management believes, after consultation with legal counsel, that the disposition of these proceedings should not have a material adverse effect on our financial position, results of operations or cash flows.

6. Employee Benefit Plan

The Company provides an Employee Retirement Savings Plan (the Retirement Plan) under Section 401(k) of the Internal Revenue Code of 1986, as amended (the Code) that covers substantially all U.S. based salaried employees. Employees may contribute a percentage of eligible compensation to the Plan, subject to certain limits under the Code. For the nine months ended September 30, 2012 and September 30, 2011, the Company did not provide for any matching contributions.

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7. Mastech Stock Incentive Plan

In 2008, the Company adopted a Stock Incentive Plan (the Plan) which provides that up to 800,000 shares of the Company s common stock shall be allocated for issuance to directors, officers and key personnel. Grants under the Plan can be made in the form of stock options, stock appreciation rights, performance shares or stock awards. During the three and nine months ended September 30, 2012, the Company granted 155,000 performance shares to various directors, officers and key employees. During the three months ended September 30, 2012, 50,000 of the performance shares were cancelled. During the three and nine months ended September 30, 2011, the company granted 0 and 6,000 stock options and 90,000 and 90,000 restricted stock awards, respectively. As of September 30, 2012, there were 84,000 shares available for grant under the Plan.

8. Stock-Based Compensation

Stock-based compensation expense for the three months ended September 30, 2012 and 2011 was $84,000 and $56,000, respectively, and for the nine months ended September 30, 2012 and 2011 was $161,000 and $182,000, respectively. Stock-based compensation expense is included in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

During the three and nine months ended September 30, 2012, the Company issued 17,092 and 47,725 shares related to the exercise of stock options and vesting of restricted stock grants. During the three and nine months ended September 30, 2011, the Company issued 0 and 18,750 shares related to the exercise of stock options.

9. Derivative Instruments and Hedging Activities

In June 2012, the Company entered into foreign currency forward contracts (derivative contracts) to mitigate and manage the risk of changes in foreign exchange rates related to highly probable expenditures in support of its Indian-based global recruitment operations. These forward contracts have been designated as cash flow hedging instruments and qualified as effective hedges at inception under ASC Topic 815, Derivatives and Hedging .

All derivatives are recognized on the balance sheet at fair value. The effective portion of the changes in fair value on these instruments are recorded in other comprehensive income (loss) and are reclassified into the Consolidated Statement of Operations on the same line item and in the same period in which the underlying hedge transaction affects earnings. Changes in the fair value of these instruments deemed ineffective are recognized in the Consolidated Statement of Operations as foreign exchange gains (losses). Hedge effectiveness is assessed based on changes in the fair value of the forward contracts related to the difference between the spot price and the forward price. Forward points (premiums/discounts) are excluded from the assessment of hedge effectiveness and are recognized in the Consolidated Statement of Operations as foreign exchange gains/(losses).

The outstanding contracts mature in nine equal monthly installments of 9 million rupees through June 2013, meet the qualifying criteria for hedge accounting and have been deemed to be effective. Accordingly, the Company has recorded other comprehensive pretax gains of $75,000 as of September 30, 2012.

The following table presents information related to foreign currency forward contracts held by the Company:

OUTSTANDING HEDGE TRANSACTIONS QUALIFYING FOR HEDGE ACCOUNTING AS OF SEPTEMBER 30, 2012 (amounts in thousands):

	Maturity Date Ranges	Rupee Strike Price Ranges	Amount	Net Unrealized Gain/(Losses) September 30, 2012
FORWARD CONTRACTS USD:				
From:	October 18, 2012	56.92		
To:	June 19, 2013	58.57		
Total			$ 1,401	$ 75

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THE EFFECT OF DERIVATIVE INSTRUMENTS ON THE CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2012

(in thousands):

Derivatives in ASC Topic 815 Cash Flow Hedging Relationships	Amount of Gain / (Loss) recognized in OCI on Derivatives (Effective Portion)	Location of Gain / (Loss) reclassified from Accumulated OCI to Income (Effective Portion)	Amount of Gain / (Loss) reclassified from Accumulated OCI to Income (Effective Portion)	Location of Gain / (Loss) reclassified in Income on Derivatives (Ineffective Portion/Amounts excluded from effectiveness testing)	Amount of Gain / (Loss) recognized in Income on Derivatives
Currency Forward Contracts	$ 71	SG&A Expense	$ 5	Other Income/ (Expense)	$ 24

THE EFFECT OF DERIVATIVE INSTRUMENTS ON THE CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012

(in thousands):

Derivatives in ASC Topic 815 Cash Flow Hedging Relationships	Amount of Gain / (Loss) recognized in OCI on Derivatives (Effective Portion)	Location of Gain / (Loss) reclassified from Accumulated OCI to Income (Effective Portion)	Amount of Gain / (Loss) reclassified from Accumulated OCI to Income (Effective Portion)	Location of Gain / (Loss) reclassified in Income on Derivatives (Ineffective Portion/Amounts excluded from effectiveness testing)	Amount of Gain / (Loss) recognized in Income on Derivatives
Currency Forward Contracts	$ 75	SG&A Expense	$ 5	Other Income/ (Expense)	$ 25

INFORMATION ON THE LOCATION AND AMOUNTS OF DERIVATIVE FAIR VALUES IN THE CONDENSED CONSOLIDATED BALANCE SHEET (in thousands):

	September 30, 2012		December 31, 2011	
Derivative Instruments	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Currency Forward Contracts	Prepaid and Other Current Assets	$ 100	Not applicable	$

The estimated amount of net gains as of September 30, 2012 that is expected to be reclassified from other comprehensive income into earnings within the next 12 months is $75,000.

10. Fair Value Measurements

ACS Topic 820 Fair Value Measurements and Disclosures defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for such asset or liability in an orderly transaction between market participants at the measurement date. ASC 820-10 establishes a three-tier value hierarchy, which prioritizes the inputs used to measure fair value. The fair value hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of input used to measure fair value are as follows:

Level 1 - Inputs are observable quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2 - Inputs are observable, other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are directly or indirectly observable in the marketplace.

Level 3 - Inputs are unobservable that are supported by little or no market activity.

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At September 30, 2012, the Company carried the following financial assets and liabilities at fair value measured on a recurring basis (in thousands):

	Fair Value Measurements Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	**Significant other Observable inputs (Level 2)**	**Unobservable inputs (Level 3)**
Current Assets:			
Currency Forward Contracts	$ 0	$ 100	$ 0

11. Income Taxes

The components of income before income taxes, as shown in the accompanying Condensed Consolidated Financial Statements, consisted of the following for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2012	**2011**	**2012**	**2011**
	(Amounts in Thousands)		**(Amounts in Thousands)**	
Income before income taxes:				
Domestic	$ 975	$ 710	$ 2,286	$ 1,383
Foreign	0	0	0	0
Income before income taxes	$ 975	$ 710	$ 2,286	$ 1,383

The provision for income taxes, as shown in the accompanying Condensed Consolidated Financial Statements, consisted of the following for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2012	**2011**	**2012**	**2011**
	(Amounts in Thousands)		**(Amounts in Thousands)**	
Current provision:				
Federal	$ 306	$ 110	$ 692	$ 424
State	29	4	63	20
Total current provision	335	114	755	444
Deferred provision:				
Federal	36	130	106	45
State	3	25	14	34
Total deferred provision	39	155	120	79

Total provision for income taxes	$ 374	$ 269	$ 875	$ 523

The reconciliation of income taxes computed using the statutory U.S. income tax rate and the provision for income taxes for the three and nine months ended September 30, 2012 and 2011 were as follows (amounts in thousands):

	Three Months Ended September 30, 2012		**Three Months Ended September 30, 2011**	
Income taxes computed at the federal statutory rate	$ 331	34.0%	$ 241	34.0%
State income taxes, net of federal tax benefit	32	3.3	29	4.0
Other net	11	1.1	(1)	(0.1)
	$ 374	38.4%	$ 269	37.9%

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	Nine Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
Income taxes computed at the federal statutory rate	$ 777	34.0%	$ 470	34.0%
State income taxes, net of federal tax benefit	77	3.4	54	3.9
Other net	21	0.9	(1)	(0.1)
	$ 875	38.3%	$ 523	37.8%

A reconciliation of the beginning and ending amounts of unrecognized tax benefits related to uncertain tax positions, including interest and penalties, are as follows:

(Amounts in thousands)	Nine Months Ended September 30, 2012
Balance as of December 31, 2011	$ 89
Additions related to current period	29
Additions related to prior periods	
Reductions related to prior periods	
Balance as of September 30, 2012	$ 118

Although it is difficult to anticipate the final outcome of these uncertain tax positions, the Company believes that the total amount of unrecognized tax benefits could be reduced by approximately $25,000 during the next twelve months due to the expiration of the statutes of limitation.

12. Shareholders Equity