

Mastech Holdings, Inc.  
Form 10-Q  
October 31, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2014**

**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**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**26-2753540**  
**(I.R.S. Employer**  
**Identification No.)**

**1305 Cherrington Parkway, Building 210, Suite 400**

**Moon Township, Pennsylvania**  
**(Address of principal executive offices)**

**15108**  
**(Zip Code)**

**(412) 787-2100**

**(Registrant's telephone number, including area code)**

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 required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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  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

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

The number of shares of the registrant's Common Stock, par value \$.01 per share, outstanding as of October 24, 2014 was 4,306,798.

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**MASTECH HOLDINGS, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2014**  
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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****MASTECH HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Amounts in thousands, except per share data)

(Unaudited)

|  | <b>Three Months<br/>Ended<br/>September 30,</b> |             | <b>Nine Months<br/>Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2014</b>                                     | <b>2013</b> | <b>2014</b>                                    | <b>2013</b> |
| Revenues   | \$ 28,634                                       | \$ 28,283   | \$ 84,974                                      | \$ 78,418   |
| Cost of revenues   | 23,407  | 22,948      | 69,416   | 63,739      |
| Gross profit   | 5,227   | 5,335       | 15,558   | 14,679      |
| Selling, general and administrative expenses   | 3,788   | 3,659       | 11,306   | 10,902      |
| Income from operations   | 1,439   | 1,676       | 4,252  | 3,777       |
| Interest income (expense), net   | (21)  | (23)        | (67)   | (77)        |
| Other income (expense), net  | (12)  | (42)        | 56   | 4           |
| Income from continuing operations before income taxes                                  | 1,406   | 1,611       | 4,241  | 3,704       |
| Income tax expense   | 527   | 612         | 1,600  | 1,396       |
| Income from continuing operations  | 879   | 999         | 2,641  | 2,308       |
| Income from discontinued operations net of tax expense of \$0, \$22, \$0 and \$68      |   | 39          |  | 94          |
| Gain on sale of discontinued operations, net of tax expense of \$0, \$43, \$0 and \$43 |   | 442         |  | 442         |
| Income from discontinued operations  |   | 481         |  | 536         |
| Net income   | \$ 879  | \$ 1,480    | \$ 2,641                                       | \$ 2,844    |
| Earnings per share:  |   |             |  |             |
| Basic:   |   |             |  |             |
| Continuing operations  | \$ .20  | \$ .24      | \$ .61   | \$ .55      |
| Discontinued operations  |   | .11         |  | .13         |
| Total  | \$ .20  | \$ .35      | \$ .61   | \$ .68      |

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Diluted:

|                         |               |               |               |               |
|-------------------------|---------------|---------------|---------------|---------------|
| Continuing operations   | \$ .20        | \$ .23        | \$ .59        | \$ .54        |
| Discontinued operations |               | .11           |               | .12           |
| <b>Total</b>            | <b>\$ .20</b> | <b>\$ .34</b> | <b>\$ .59</b> | <b>\$ .66</b> |

Weighted average common shares outstanding:

|         |       |       |       |       |
|---------|-------|-------|-------|-------|
| Basic   | 4,330 | 4,190 | 4,319 | 4,183 |
| Diluted | 4,464 | 4,320 | 4,461 | 4,301 |

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 |          | Nine Months Ended |          |
|---|--------------------|----------|-------------------|----------|
|   | September 30,      |          | September 30,     |          |
|   | 2014               | 2013     | 2014              | 2013     |
| Net income  | \$ 879             | \$ 1,480 | \$ 2,641          | \$ 2,844 |
| Other comprehensive income (loss):                    |                    |          |                   |          |
| Net unrealized gain/(loss) on cash flow hedges        | (51)               | 20       | (16)              | (75)     |
| Income tax expense (benefit)                          | (20)               | 8        | (6)               | (29)     |
| Total other comprehensive income (loss), net of taxes | \$ (31)            | \$ 12    | \$ (10)           | \$ (46)  |
| Total comprehensive income                            | \$ 848             | \$ 1,492 | \$ 2,631          | \$ 2,798 |

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

**Table of Contents****MASTECH HOLDINGS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Amounts in thousands, except share and per share data)****(Unaudited)**

|   | <b>September 30,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|---|-------------------------------|------------------------------|
| <b>ASSETS</b>   |                               |                              |
| Current assets:   |                               |                              |
| Cash and cash equivalents   | \$ 2,548                      | \$ 424                       |
| Accounts receivable, net of allowance for uncollectible accounts of \$260 in 2014 and \$358 in 2013 | 11,315                        | 10,707                       |
| Unbilled receivables  | 4,459                         | 4,304                        |
| Prepaid and other current assets  | 940                           | 822                          |
| Deferred income taxes   | 161                           | 143                          |
| Total current assets  | 19,423                        | 16,400                       |
| Equipment, enterprise software, and leasehold improvements, at cost:                                |                               |                              |
| Equipment   | 914                           | 1,688                        |
| Enterprise software   | 549                           | 723                          |
| Leasehold improvements  | 255                           | 547                          |
|   | 1,718                         | 2,958                        |
| Less accumulated depreciation   | (1,220)                       | (2,784)                      |
| Net equipment, enterprise software, and leasehold improvements                                      | 498                           | 174                          |
| Deferred income taxes   | 197                           | 248                          |
| Deferred financing costs, net   | 56                            | 19                           |
| Non-current deposits  | 211                           | 210                          |
| Total assets  | \$ 20,385                     | \$ 17,051                    |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                               |                              |
| Current liabilities:  |                               |                              |
| Short-term borrowings   | \$                            | \$ 12                        |
| Accounts payable  | 1,478                         | 2,026                        |
| Accrued payroll and related costs   | 6,245                         | 5,202                        |
| Other accrued liabilities   | 296                           | 304                          |
| Deferred revenue  | 175                           | 47                           |
| Total current liabilities   | 8,194                         | 7,591                        |

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|   |           |           |
|---|-----------|-----------|
| Total liabilities   | 8,194     | 7,591     |
| Commitments and contingent liabilities (Note 3)   |           |           |
| Shareholders' equity:   |           |           |
| Preferred Stock, no par value; 20,000,000 shares authorized; none outstanding   |           |           |
| Common Stock, par value \$.01; 125,000,000 shares authorized and 5,091,368 shares issued as of September 30, 2014 and 4,974,506 shares issued as of December 31, 2013 | 51        | 50        |
| Additional paid-in-capital  | 12,686    | 11,924    |
| Retained earnings   | 3,242     | 601       |
| Accumulated other comprehensive income  | 6         | 16        |
| Treasury stock, at cost; 784,570 shares as of September 30, 2014 and 732,958 as of December 31, 2013  | (3,794)   | (3,131)   |
| Total shareholders' equity  | 12,191    | 9,460     |
| Total liabilities and shareholders' equity  | \$ 20,385 | \$ 17,051 |

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



Table of Contents**MASTECH HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Amounts in thousands)****(Unaudited)**

|  | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|--|-------------|
|  | <b>2014</b>                                | <b>2013</b> |
| <b>OPERATING ACTIVITIES:</b>   |  |             |
| Net income   | \$ 2,641                                   | \$ 2,844    |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities of continuing operations: |  |             |
| (Net income) from discontinued operations, net of tax  |  | (536)       |
| Depreciation and amortization  | 91   | 123         |
| Interest amortization of deferred financing costs  | 23   | 21          |
| Stock-based compensation expense   | 295  | 257         |
| Deferred income taxes, net   | 9  | (65)        |
| Loss on derivative contract  | 11   | 21          |
| Loss on fixed asset retirements  | 8  | 1           |
| Working capital items:   |  |             |
| Accounts receivable and unbilled receivables   | (829)                                      | (3,301)     |
| Prepaid and other current assets   | (138)                                      | (265)       |
| Accounts payable   | (530)                                      | 644         |
| Accrued payroll and related costs  | 1,043                                      | 2,016       |
| Other accrued liabilities  | 33   | (41)        |
| Deferred revenue   | 128  | (125)       |
| Net cash flows provided by operating activities of continuing operations   | 2,785                                      | 1,594       |
| Net cash flows provided by operating activities of discontinued operations   | 31   | 979         |
| Net cash flows provided by operating activities  | 2,816                                      | 2,573       |
| <b>INVESTING ACTIVITIES:</b>   |  |             |
| (Payment for) recovery of non-current deposits   | (1)  | 14          |
| Capital expenditures   | (423)                                      | (78)        |
| Net cash flows (used in) investing activities of continuing operations   | (424)                                      | (64)        |
| Net cash flows provided by investing activities of discontinued operations   |  | 996         |
| Net cash flows provided by (used in) investing activities  | (424)                                      | 932         |
| <b>FINANCING ACTIVITIES:</b>   |  |             |

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|   |          |          |
|---|----------|----------|
| Repayments of short-term borrowings, net  | (12)     | (2,610)  |
| Payment of deferred financing costs   | (60)     |          |
| Purchase of treasury stock  | (663)    | (16)     |
| Proceeds from the exercise of stock options                                     | 13       | 16       |
| Increase in excess tax benefits related to stock options/restricted shares, net | 454      | 60       |
| Net cash flows (used in) financing activities of continuing operations          | (268)    | (2,550)  |
| Net cash flows (used in) financing activities of discontinued operations        |          |          |
| Net cash flows (used in) financing activities                                   | (268)    | (2,550)  |
| Net change in cash and cash equivalents   | 2,124    | 955      |
| Cash and cash equivalents, beginning of period                                  | 424      | 659      |
| Cash and cash equivalents, end of period  | \$ 2,548 | \$ 1,614 |

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, 2014 AND 2013**

**(Unaudited)**

**1. Description of Business and Basis of Presentation:**

References in this Quarterly Report on Form 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 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.

***Basis of Presentation***

The accompanying 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 for the year ended December 31, 2013, included in our Annual Report on Form 10-K filed with the SEC on March 21, 2014. Additionally, our operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that can be expected for the year ending December 31, 2014 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.

***Critical Accounting Policies***

Please refer to Note 1 Summary of Significant Accounting Policies of the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2013 for a more detailed discussion of our significant accounting policies and critical accounting estimates. There were no material changes to these critical accounting policies during the nine months ended September 30, 2014.

### ***Segment Reporting***

The Company has one reportable segment in accordance with ASC Topic 280 Disclosures About Segments of an Enterprise and Related Information .

### **2. Discontinued Operations**

In August 2013, the Company sold its healthcare staffing business to Accountable Healthcare Staffing, Inc. Under the terms of the Sales and Purchase Agreement the purchase price totaled \$1.15 million and consisted of \$1 million cash consideration at closing, plus the assumption of certain liabilities by the buyer. Total net assets sold excluded cash balances on hand, accounts receivables and other current assets which approximated \$1.5 million, net of current liabilities retained by the Company, at the transaction date.

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The healthcare staffing business meets the criteria for being reported as a discontinued operation and has been segregated from continuing operations. Accordingly, the Condensed Consolidated Statements of Operations and Cash Flows for all periods presented have been recast to reflect the presentation of discontinued operations. Unless otherwise indicated, all disclosures in these Notes to Condensed Consolidated Financial Statements relate to the Company's continuing operations.

The carrying value of assets and liabilities of discontinued operations included in the September 30, 2014 and December 31, 2013 Condensed Consolidated Balance Sheets were as follows (in thousands):

|                                | At<br>September 30, 2014 | At<br>December 31, 2013 |
|--------------------------------|--------------------------|-------------------------|
| <b>ASSETS:</b>                 |                          |                         |
| Accounts receivables           | \$ 2                     | \$ 68                   |
| Deferred income taxes          |                          | 24                      |
| Non-current deposits           | 19                       | 19                      |
| <b>Total</b>                   | <b>21</b>                | <b>111</b>              |
| <b>LIABILITIES:</b>            |                          |                         |
| Accounts payable               | 5                        | 23                      |
| Other accrued liabilities      | 133                      | 174                     |
| <b>Total</b>                   | <b>138</b>               | <b>197</b>              |
| <b>TOTAL NET (LIABILITIES)</b> | <b>\$ (117)</b>          | <b>\$ (86)</b>          |

The Condensed Statements of Operations of discontinued operations were as follows (in thousands):

|  | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |              |
|--|-------------------------------------|--------------|------------------------------------|--------------|
|  | 2014                                | 2013         | 2014                               | 2013         |
| Revenues                                     | \$                                  | \$ 1,253     | \$                                 | \$ 7,058     |
| Costs of revenues                            |                                     | 1,045        |                                    | 5,856        |
| <b>Gross profit</b>                          |                                     | <b>208</b>   |                                    | <b>1,202</b> |
| Selling, general and administrative expenses |                                     | 147          |                                    | 1,040        |
| <b>Income before income taxes</b>            |                                     | <b>61</b>    |                                    | <b>162</b>   |
| Income tax expense                           |                                     | 22           |                                    | 68           |
| <b>Net income</b>                            | <b>\$</b>                           | <b>\$ 39</b> | <b>\$</b>                          | <b>\$ 94</b> |

The August 2013 gain on the sale of the healthcare business was as follows (in thousands):

|                                 | <b>Three Months Ended</b> |               | <b>Nine Months Ended</b> |               |
|---------------------------------|---------------------------|---------------|--------------------------|---------------|
|                                 | <b>September 30,</b>      |               | <b>September 30,</b>     |               |
|                                 | <b>2014</b>               | <b>2013</b>   | <b>2014</b>              | <b>2013</b>   |
| Pretax gain on sale transaction | \$                        | \$ 485        | \$                       | \$ 485        |
| Income tax expense              |                           | 43            |                          | 43            |
| <b>Net gain</b>                 | <b>\$</b>                 | <b>\$ 442</b> | <b>\$</b>                | <b>\$ 442</b> |

Income tax expense on the sale transaction included the utilization of \$147,000 of tax benefits (capital loss carry-forwards) which were previously deemed non-realizable by the Company.

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The cash flows provided by (used in) discontinued operations were as follows (in thousands):

|   | <b>Nine Months Ended<br/>September 30,</b> |                 |
|---|--|-----------------|
|   | <b>2014</b>                                | <b>2013</b>     |
| <b>OPERATING ACTIVITIES:</b>  |  |                 |
| Net income from discontinued operations   | \$   | \$ 536          |
| Adjustments to reconcile net income to net cash provided by<br>(used in) operating activities of discontinued operations: |  |                 |
| Depreciation and amortization   |  | 16              |
| Bad debt (credit) expense   |  | (25)            |
| Stock-based compensation expense  |  | (15)            |
| Deferred income taxes, net  | 24   | (25)            |
| (Gain) on sale of discontinued operations, net of tax   |  | (442)           |
| <b>Working capital items:</b>   |  |                 |
| Accounts receivable and unbilled receivables  | 66   | 1,291           |
| Prepaid and other current assets  |  | 41              |
| Accounts payable  | (18)                                       | (89)            |
| Accrued payroll and related costs   |  | (363)           |
| Other accrued liabilities   | (41)                                       | 54              |
| <b>Total cash provided by operating activities of discontinued<br/>operations</b>   | <b>31</b>                                  | <b>979</b>      |
| <b>INVESTING ACTIVITIES:</b>  |  |                 |
| (Payment for) recovery of non-current deposits  |  | (10)            |
| Capital expenditures  |  | (3)             |
| Proceeds from sale of discontinued operations   |  | 1,009           |
| <b>Total cash provided by investing activities of discontinued<br/>operations</b>   |  | <b>996</b>      |
| <b>FINANCING ACTIVITIES:</b>  |  |                 |
| None  |  |                 |
| <b>Total cash flow provided by discontinued operations</b>  | <b>\$ 31</b>                               | <b>\$ 1,975</b> |

**3. Commitments and Contingencies*****Lease Commitments***

The Company rents certain office space and equipment under non-cancelable leases which provides for future minimum rental payments. On April 2, 2014, the Company entered into a ten year operating lease for 11,495 useable square feet of office space in suburban Pittsburgh, PA. This lease replaced the Company's existing Corporate Headquarters lease effective August 29, 2014. Annual lease payments over the ten year period will approximate \$2 million in the aggregate. The lease is cancelable, with penalty, at the end of year seven and provides the right to sublease throughout the lease term.

Except for the new office lease commitment mentioned above, total lease commitments have not materially changed from the amounts disclosed in the Company's 2013 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.

**4. 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 Retirement Plan, subject to certain limits under the Code. For the nine months ended September 30, 2014 and September 30, 2013, the Company did not provide for any matching contributions.



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### **5. Mastech Stock Incentive Plan**

In 2008, the Company adopted a Stock Incentive Plan (the Plan) which, as amended, provides that up to 1,200,000 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, 2014, there were 45,000 restricted share grants made under this Plan. For the three and nine months ended September 30, 2013, the Company granted -0- and 62,500 performance shares to an executive officer.

As of September 30, 2014, there were 178,000 shares available for grant under the Plan.

### **6. Stock-Based Compensation**

Stock-based compensation expense for the three months ended September 30, 2014 and 2013 was \$123,000 and \$90,000, respectively, and for the nine months ended September 30, 2014 and 2013 was \$295,000 and \$257,000, 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, 2014, the Company issued 31,250 shares and 116,862 shares related to the exercise of stock options and vesting of restricted stock/performance share grants. During the three and nine months ended September 30, 2013, the Company issued 17,501 shares and 25,647 shares related to the exercise of stock options and vesting of restricted stock grants.

### **7. Credit Facility**

On July 11, 2014, the Company entered into a Second Amended and Restated Loan Agreement (the Loan Agreement) with PNC Bank, N.A. (PNC), replacing its previous credit facility with PNC that was set to expire on August 31, 2014. The new facility expires in three years and provides for up to \$20 million of credit, subject to borrowing base limits and commitment reductions and mandatory prepayments, as described in the Loan Agreement filed as Exhibit 10.1 to the Company's current report on Form 8-K, filed with the SEC on July 17, 2014.

Advances under revolving credit loans are limited to a borrowing base that consist of the sum of 85% of eligible accounts receivable and 60% of eligible unbilled accounts. The credit facility includes sub-facilities in aggregate amounts not to exceed (i) \$1 million for letters of credit and (ii) \$5 million for permitted acquisitions. Revolving credit loans made for the purpose of financing permitted acquisitions will be converted into term loans with five year maturities and the credit facility will be reduced by an amount equal to each converted term loan. The credit facility also includes an accordion feature which may be exercised by the Company to increase the loan commitment by an aggregate amount of up to \$10 million, subject to PNC's approval.

Interest on borrowings will be charged at a rate equal to, at the Company's election, either (a) the higher of PNC's prime rate or the federal funds rate plus 0.50%, plus an applicable margin; or (b) adjusted LIBOR plus an applicable margin. The applicable margin on the base rate is between 0.25% and 0.75% on revolving credit loans and between 0.75% and 1.25% on the term loans. The applicable margin on the adjusted LIBOR rate is between 1.25% and 1.75% on revolving credit loans and between 1.75% and 2.25% on the term loans. The actual applicable margin is based on the Company's senior leverage ratio, as defined in the Loan Agreement. A 20 basis point per annum commitment fee on the unused portion of the facility is charged and due quarterly in arrears. As of September 30, 2014, the Company had no outstanding borrowings under the revolving credit loan facility and unused borrowing availability of \$17.4

million.

The Loan Agreement contains standard financial covenants, including but not limited to, covenants related to the Company's leverage ratio, senior leverage ratio and fixed charge ratio (as defined under the Loan Agreement) and limitations on liens, indebtedness, guarantees and contingent liabilities, loans and investments, distributions, leases, asset sales, stock repurchases and mergers and acquisitions. As of September 30, 2014, the Company was in compliance with all provisions under the facility.

In connection with securing this facility, the Company incurred transaction costs totaling \$60,000. These costs are being amortized as interest expense over the three-year life of the credit facility.

## **8. Income Taxes**

The components of income before income taxes from continuing operations, as shown in the accompanying Condensed Consolidated Financial Statements, consisted of the following for the three and nine months ended September 30, 2014 and 2013:

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|                             | Three Months Ended<br>September 30,<br>2014 |          | September 30,<br>2013  |          |
|-----------------------------|---|----------|------------------------|----------|
|                             | (Amounts in Thousands)                      |          | (Amounts in Thousands) |          |
| Income before income taxes: |   |          |                        |          |
| Domestic                    | \$ 1,406                                    | \$ 1,611 | \$ 4,241               | \$ 3,704 |
| Foreign                     |   |          |                        |          |
| Income before income taxes  | \$ 1,406                                    | \$ 1,611 | \$ 4,241               | \$ 3,704 |

The provision for income taxes from continuing operations, as shown in the accompanying Condensed Consolidated Financial Statements, consisted of the following for the three and nine months ended September 30, 2014 and 2013:

|                                    | Three Months Ended<br>September 30,<br>2014 |        | September 30,<br>2013  |          |
|------------------------------------|---|--------|------------------------|----------|
|                                    | (Amounts in Thousands)                      |        | (Amounts in Thousands) |          |
| Current provision:                 |   |        |                        |          |
| Federal                            | \$ 469                                      | \$ 543 | \$ 1,444               | \$ 1,330 |
| State                              | 44  | 58     | 147                    | 131      |
| Total current provision            | 513   | 601    | 1,591                  | 1,461    |
| Deferred provision:                |   |        |                        |          |
| Federal                            | 12  | 10     | 8                      | (57)     |
| State                              | 2   | 1      | 1                      | (8)      |
| Total deferred provision (benefit) | 14  | 11     | 9                      | (65)     |
| Total provision for income taxes   | \$ 527                                      | \$ 612 | \$ 1,600               | \$ 1,396 |

The reconciliation of income taxes computed using the statutory U.S. income tax rate and the provision for income taxes from continuing operations for the three and nine months ended September 30, 2014 and 2013 were as follows (amounts in thousands):

|   | Three Months Ended<br>September 30, 2014 |       | Three Months Ended<br>September 30, 2013 |       |
|---|--|-------|--|-------|
| Income taxes computed at the federal statutory rate | \$ 478                                   | 34.0% | \$ 548                                   | 34.0% |
| State income taxes, net of federal tax benefit      | 46                                       | 3.3   | 59                                       | 3.7   |
| Other net   | 3  | 0.2   | 5  | 0.3   |
|   | \$ 527                                   | 37.5% | \$ 612                                   | 38.0% |

|   | <b>Nine Months Ended<br/>September 30, 2014</b> |       | <b>Nine Months Ended<br/>September 30, 2013</b> |       |
|---|---|-------|---|-------|
| Income taxes computed at the federal statutory rate | \$ 1,442  | 34.0% | \$ 1,259  | 34.0% |
| State income taxes, net of federal tax benefit      | 148   | 3.5   | 123   | 3.3   |
| Other net   | 10  | 0.2   | 14  | 0.4   |
|   | \$ 1,600  | 37.7% | \$ 1,396  | 37.7% |

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

| <b>(Amounts in thousands)</b>       | <b>Nine Months Ended<br/>September 30, 2014</b> |
|-------------------------------------|---|
| Balance as of December 31, 2013     | \$ 111  |
| Additions related to current period | 33  |
| Additions related to prior periods  |   |
| Reductions related to prior periods | (13)  |
| Balance as of September 30, 2014    | \$ 131  |

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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 \$38,000 during the next twelve months due to the expiration of the statute of limitations.

**9. Derivative Instruments and Hedging Activities**

The Company enters 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 is recorded in other comprehensive income (loss) and is reclassified into the Consolidated Statements 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 Statements 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 Statements of Operations as foreign exchange gains/(losses).

As of September 30, 2014, the Company's outstanding contracts total 96 million Indian rupees (10 million rupees per month mature in three equal installments from October 2014 through December 2014 and 5.5 million rupees per month mature in twelve equal installments from January 2015 through December 2015).

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, 2014 (amounts in thousands):**

|                               | Maturity Date Ranges | Rupee Strike Price Ranges | Net Unrealized Gain/(Loss) Amount |       |
|-------------------------------|----------------------|---------------------------|-----------------------------------|-------|
|                               |                      |                           | September 30, 2014                |       |
| <b>Forward contracts USD:</b> |                      |                           |                                   |       |
| From:                         | October 20, 2014     |                           |                                   |       |
| To:                           | December 18, 2015    | 62.35 - 70.41             |                                   |       |
| Total                         |                      |                           | \$ 1,458                          | \$ 11 |

The effect of derivative instruments on the Condensed Consolidated Statements of Operations and Comprehensive Income are as follows (in thousands):

| Derivatives in ASC Topic 815 Cash Flow Hedging Relationships | Amount of Gain / (Loss) | Location of Gain / (Loss) reclassified from | Amount of Gain / (Loss) | Location of Gain / (Loss) reclassified in Income | Amount of Gain / (Loss) |
|--|-------------------------|---|-------------------------|--|-------------------------|
|--|-------------------------|---|-------------------------|--|-------------------------|

|   | recognized OCI on Derivatives | accumulated OCI to Income (Expense) | (Loss) reclassified from accumulated OCI to Income (Expense) | (Expense) on Derivatives | (Loss) recognized in Income (Expense) on Derivatives |
|---|-------------------------------|-------------------------------------|--|--------------------------|--|
|   | (Effective Portion)           | (Effective Portion)                 | (Effective Portion) excluded from effectiveness testing)     |                          |  |
| <b>For the Three Months Ended September 30, 2014:</b> |                               |                                     |  |                          |  |
| Currency Forward Contracts                            | \$ (51)                       | SG&A Expense                        | \$ 29  | Other Income/ (Expense)  | \$ (1)   |
| <b>For the Nine Months Ended September 30, 2014:</b>  |                               |                                     |  |                          |  |
| Currency Forward Contracts                            | \$ (16)                       | SG&A Expense                        | \$ 33  | Other Income/ (Expense)  | \$ 67  |
| <b>For the Three Months Ended September 30, 2013:</b> |                               |                                     |  |                          |  |
| Currency Forward Contracts                            | \$ 20                         | SG&A Expense                        | \$ (16)  | Other Income/ (Expense)  | \$ (40)  |
| <b>For the Nine Months Ended September 30, 2013:</b>  |                               |                                     |  |                          |  |
| Currency Forward Contracts                            | \$ (75)                       | SG&A Expense                        | \$ (12)  | Other Income/ (Expense)  | \$ 1   |

**Table of Contents****Information on the location and amounts of derivative fair values in the Condensed Consolidated Balance Sheets (in thousands):**

| Derivative Instruments     | September 30, 2014               |            | December 31, 2013                |            |
|----------------------------|----------------------------------|------------|----------------------------------|------------|
|                            | Balance Sheet Location           | Fair Value | Balance Sheet Location           | Fair Value |
| Currency Forward Contracts | Prepaid and Other Current Assets | \$ 39      | Prepaid and Other Current Assets | \$ 67      |

The estimated amount of pretax gains as of September 30, 2014 that are expected to be reclassified from other comprehensive (loss) into earnings within the next 12 months is \$13,000.

**10. Fair Value Measurements**

The Company has adopted the provisions of ASC 820, Fair Value Measurements and Disclosures (ASC 820) related to certain financial and nonfinancial assets and liabilities. ASC 820 establishes the authoritative definition of fair value; sets out a framework for measuring fair value; and expands the required disclosures about fair value measurements. The valuation techniques required by ASC 820 are based on observable and unobservable inputs using the following three-tier hierarchy:

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.

At September 30, 2014 and December 31, 2013, the Company carried the following financial assets at fair value measured on a recurring basis (in thousands):

| (Amounts in thousands)     | Fair Value as of September 30, 2014 |         |         |
|----------------------------|-------------------------------------|---------|---------|
|                            | Level 1                             | Level 2 | Level 3 |
| Currency Forward Contracts | \$ 0                                | \$ 39   | \$ 0    |

  

| (Amounts in thousands)     | Fair Value as of December 31, 2013 |         |         |
|----------------------------|------------------------------------|---------|---------|
|                            | Level 1                            | Level 2 | Level 3 |
| Currency Forward Contracts | \$ 0                               | \$ 67   | \$ 0    |

### **11. Shareholders Equity**

As of September 30, 2014, the Company had 494,611 shares available for purchase under its existing share repurchase program. Repurchases under the program may be made through open market purchases or privately negotiated transactions in accordance with applicable securities laws through December 22, 2014. During the three and nine months ended September 30, 2014, the Company repurchased 22,430 shares of common stock under the program at an average price of \$11.86 per share. Additionally, during the three and nine months ended September 30, 2014, the Company purchased an additional 9,841 shares and 29,182 shares, respectively, to satisfy employee tax obligations related to the vesting of performance shares. These purchases were made at an average share price of \$12.78 and \$13.63, respectively. During the three and nine months ended September 30, 2013, -0- and 2,744 shares were repurchased under this program.



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**12. Revenue Concentration**

For the three months ended September 30, 2014, the Company had three clients that exceeded 10% of total revenues (Accenture = 12.4%, TEK Systems = 10.5% and CGI = 10.2%). For the three months ended September 30, 2013, the Company had one client that exceeded 10% of total revenues (Accenture = 12.6%). For the nine months ended September 30, 2014, the Company had one client that exceeded 10% of total revenues (Accenture = 11.3%). For the nine months ended September 30, 2013, the Company had one client that exceeded 10% of total revenues (Accenture = 11.1%).

The Company's top ten clients represented approximately 60% and 56% of total revenues for the three months ended September 30, 2014 and 2013, respectively. For the nine months ended September 30, 2014 and 2013, the Company's top ten clients represented approximately 60% and 57% of total revenues, respectively.

**13. Earnings Per Share**

The computation of basic earnings per share is based on the Company's net income divided by the weighted average number of common shares outstanding. Diluted earnings per share reflect the potential dilution that could occur if outstanding stock options were exercised and restricted shares vested. The dilutive effect of stock options was calculated using the treasury stock method.

For the three and nine months ended September 30, 2014 and 2013, there were no anti-dilutive stock options excluded from the computation of diluted earnings per share.

**14. Subsequent Event**

On October 22, 2014, the Company's Board of Directors agreed to extend the duration of the Company's existing Share Repurchase Program for an additional two years, through December 22, 2016. Currently there are approximately 495,000 shares yet to be purchased under the program.

**15. Recently Issued Accounting Standards**

In **April 2014**, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. The main objective of this update is to change the criteria for reporting discontinued operations and enhancing convergence of the FASB's and the International Accounting Standard Board's (IASB) reporting requirements for discontinued operations.

The amendments in this Update affect an entity that has either of the following:

- 1) A component of an entity that either is disposed of or meets the criteria in paragraph 205-20-45-1E to be classified as held for sale.
  
- 2)

A business activity that, on acquisition, meets the criteria in paragraph 205-20-45-1E to be classified as held for sale.

The amendments in this Update improve the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results. Under current U.S. GAAP, many disposals, some of which may be routine in nature and not a change in an entity's strategy, are reported in discontinued operations. The amendments in this Update require expanded disclosures for discontinued operations. The Board concluded that those disclosures should provide users of financial statements with more information about the assets, liabilities, revenues, and expenses of discontinued operations.

The amendments in this Update also require an entity to disclose the pretax profit or loss of an individually significant component of an entity that does not qualify for discontinued operations reporting. The Board concluded that this disclosure should provide users with information about the financial effects of significant disposals that do not qualify for discontinued operations reporting.

The amendments in this Update include several changes to the Accounting Standards Codification to improve the organization and readability of Subtopic 205-20 and Subtopic 360-10, Property, Plant, and Equipment Overall. For example, the disclosures required by Subtopic 205-20 are organized by the nature of the discontinued operation. Additionally, flowcharts were added to Subtopics 205-20 and 360-10 to help stakeholders implement the disclosure requirements.

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A public business entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market should apply the amendments in this Update prospectively to both of the following:

- 1) All disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years.
- 2) All businesses that, on acquisition, are classified as held for sale that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years.

An entity should not apply the amendments in this Update to a component of an entity, or a business activity, that is classified as held for sale before the effective date even if the component of an entity, or business activity, is disposed of after the effective date. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance.

The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In **May 2014**, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. Previous revenue recognition requirements in U.S. generally accepted accounting principles (GAAP) differ from those in International Financial Reporting Standards (IFRS), and both sets of requirements were in need of improvement. Previous revenue recognition guidance in U.S. GAAP comprised broad revenue recognition concepts together with numerous revenue requirements for particular industries or transactions, which sometimes resulted in different accounting for economically similar transactions. In contrast, IFRS provided limited guidance and, consequently, the two main revenue recognition standards, IAS 18, Revenue, and IAS 11, Construction Contracts, could be difficult to apply to complex transactions. Additionally, IAS 18 provides limited guidance on important revenue topics such as accounting for multiple-element arrangements. Accordingly, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS.

The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU provides specific steps to follow in order for an entity to achieve this core principle.

For a public entity, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted.

The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In **June 2014**, the Financial Accounting Standards Board (FASB) issued Update 2014-12, *Compensation - Stock Compensation (Topic 718) Accounting for Share-Based Payments When the Terms of an Award Provide That a*

*Performance Target Could Be Achieved after the Requisite Service Period.* Generally, share-based payment awards require a specific performance target to be achieved in order for employees to become eligible to vest in the awards. Also, an award with a performance target generally requires an employee to render service until the performance target is achieved. In some cases, however, the terms of an award may provide that the performance target could be achieved after an employee completes the requisite service period. That is, the employee would be eligible to vest in the award regardless of whether the employee is rendering service on the date the performance target is achieved. This Update is intended to resolve the diverse accounting treatment of those awards in practice.

The amendments in this Update apply to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period.

The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. As indicated in the definition of vest, the stated vesting period (which includes the period in which the performance target could be achieved) may differ from the requisite service period.

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For all entities, the amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted.

The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

You should read the following discussion in conjunction with our audited consolidated financial statements and accompanying notes for the year ended December 31, 2013, included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission ( SEC ) on March 21, 2014.

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements about future events, future performance, plans, strategies, expectations, prospects, competitive environment and regulations. Forward-looking statements include all statements that are not historical facts and can be identified by the use of forward-looking terminology such as the words, may , will , expect , anticipate , believe , estimate , plan , intend or the negative of these terms or similar expressions in this quarterly report on Form 10-Q. We have based these forward-looking statements on our current views with respect to future events and financial performance. Our actual financial performance could differ materially from those projected in the forward-looking statements due to the inherent uncertainty of estimates, forecasts and projections and our financial performance may be better or worse than anticipated. Given these uncertainties, you should not put undue reliance on any forward-looking statements. All of the forward-looking statements are qualified in their entirety by reference to the factors discussed under Risk Factors , Forward-Looking Statements and elsewhere in our 2013 Annual Report on Form 10-K. Forward-looking statements represent our estimates and assumptions only as of the date that they were made. We do not undertake any duty to update forward-looking statements and the estimates and assumptions associated with them, after the date of this quarterly report on Form 10-Q, except to the extent required by applicable securities laws.

***Website Access to SEC Reports:***

The Company's website is [www.mastech.com](http://www.mastech.com). The Company's 2013 Annual Report on Form 10-K, current reports on Form 8-K and all other reports filed with the SEC, are available free of charge on the Investor Relations page. The website is updated as soon as reasonably practical after such reports are filed electronically with the SEC.

***Recent Developments***

On July 11, 2014, the Company entered into a Second Amended and Restated Loan Agreement (the Loan Agreement ) with PNC Bank, N.A. ( Bank ), replacing its previous Bank credit facility that was set to expire on August 31, 2014. This new facility expires in three years and provides for up to \$20 million of credit, subject to a borrowing base and commitment reductions and mandatory prepayments, as described in the Loan Agreement filed as Exhibit 10.1 to the Company's current report on Form 8-K, filed with the SEC on July 17, 2014. See Note 7 of the accompanying financial statements for additional details.

On October 22, 2014, the Company's Board of Directors agreed to extend the duration of the Company's existing Share Repurchase Program for an additional two years, through December 22, 2016. Currently there are approximately 495,000 shares yet to be purchased under the program.

***Critical Accounting Policies and Estimates:***

The Company's significant accounting policies and critical accounting estimates are described in Note 1 Summary of Significant Accounting Policies of the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2013. There were no material changes to these critical accounting policies during the nine months ended September 30, 2014.

***Overview:***

We are a domestic provider of IT staffing services to mostly large and medium-sized organizations. From July 1986 until our September 2008 spin-off, we conducted our business as subsidiaries of iGATE Corporation. We do not sell, lease or otherwise market computer software or hardware, and 100% of our revenue is derived from the sale of 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 e-Business solutions. We provide our services across various industry verticals including: automotive; consumer products; education; financial services; government; healthcare; manufacturing; retail; technology; telecommunications; transportation; and utilities.

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We have one operating segment. Thus, no segment related disclosures are presented. We do, however, track and evaluate our revenues and gross profits by three distinct sales channels: wholesale IT; retail IT; and permanent placements / fees. Our wholesale IT channel consists of system integrators and other IT staffing firms with a need to supplement their abilities to attract highly-qualified temporary technical computer personnel. Our retail IT channel focuses on clients that are end-users of IT staffing services. Within the retail channel are end-user clients that have retained a third party to provide vendor management services, commonly known in the industry as Managed Service Providers ( MSP ). Permanent placement / fee revenues are incidental revenues derived as by-product opportunities of conducting our core contract staffing business.

### ***Economic Trends and Outlook:***

Generally, our business outlook is highly correlated with general U.S. economic conditions. During periods of increasing employment and economic expansion, demand for our services tends to increase. Conversely, during periods of contracting employment and / or a slowing domestic economy, demand for our services tends to decline. As the economy slowed during the second half of 2007 and recessionary conditions emerged in 2008 and during much of 2009, we experienced less demand for our staffing services. During the second half of 2009, we began to see signs of market stabilization and a modest pick-up in activity levels within certain sales channels and technologies. In 2010, market conditions continued to strengthen over the course of the year and activity levels within most of our sales channels progressively improved. In 2011, 2012 and 2013, activity levels continued to trend -up in most technologies and sales channels. During the first nine months of 2014, activity levels have stabilized and remain largely consistent with the second half of 2013.

In addition to tracking general U.S. economic conditions, a large portion of our revenues are generated from a limited number of clients. Accordingly, our trends and outlook are impacted by the prospects and well-being of these specific clients. This account concentration factor may cause our results of operations to deviate from the prevailing U.S. economic trends from time to time.

In recent years, a larger portion of our revenues have come from our wholesale IT sales channel, which consists largely of strategic relationships with systems integrators and other staffing organizations. This channel tends to carry lower gross margins, but provides higher volume opportunities. This trend in our business mix has impacted overall gross margins during the past several years, and if this trend continues, will likely impact future gross margins as well. Within our retail sales channel, many larger users of IT staffing services are employing MSP s to manage their contractor spending in an effort to drive down overall costs. This trend towards utilizing the MSP model has resulted in lower gross margins in the retail IT channel over the last two years and it is likely that our gross margins will be pressured in future periods should this trend continue.

### ***Results of Continuing Operations for the Three Months Ended September 30, 2014 as Compared to the Three Months Ended September 30, 2013:***

#### ***Revenues:***

Revenues for the three months ended September 30, 2014 totaled \$28.6 million, compared to \$28.3 million for the corresponding three month period in 2013. This modest year-over-year revenue increase reflected higher demand for the Company s services and the corresponding increase in billable consultants on assignment during the 2014 period, partially offset by a lower average bill rate. Additionally, an early project termination during the second quarter of 2014 had a negative impact on this quarter s revenue performance. Billable consultant headcount at September 30, 2014 totaled 761 consultants compared to 734 consultants, one-year earlier. During the three months ended September 30, 2104, billable consultants on assignment increased by approximately 4-percent.



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Below is a tabular presentation of revenues by sales channel for the three months ended September 30, 2014 and 2013, respectively:

| <b>Revenues (Amounts in millions)</b> | <b>Three Months Ended<br/>September 30, 2014</b> | <b>Three Months Ended<br/>September 30, 2013</b> |
|---------------------------------------|--|--|
| Wholesale IT Channel                  | \$ 22.5  | \$ 22.2  |
| Retail IT Channel                     | 6.0  | 6.0  |
| Permanent Placements / Fees           | 0.1  | 0.1  |
| <br>Total revenues                    | <br>\$ 28.6                                      | <br>\$ 28.3                                      |

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Revenues from our wholesale IT channel increased slightly in the three month period ended September 30, 2014 compared to the corresponding 2013 period. Higher revenue levels from our staffing clients (up 5%) were partially offset by modest declines from our integrator clients (down 2%). An early project termination at one of our integrator partners negatively impacted this channel's revenues during the 2014 period. Retail IT channel revenues were flat during the three months ended September 30, 2014, compared to the period one-year earlier as lower revenues from direct end-user clients were essentially off-set by higher revenues from MSP clients. Permanent placement / fee revenues were approximately \$0.1 million in both the 2014 and 2013 three month periods ended September 30.

For the three months ended September 30, 2014, the Company had three clients that exceeded 10% of total revenues (Accenture = 12.4%, TEK Systems = 10.5% and CGI = 10.2%). For the three months ended September 30, 2013, the Company had one client that exceeded 10% of total revenues (Accenture = 12.6%).

The Company's top ten clients represented approximately 60% and 56% of total revenues for the three months ended September 30, 2014 and 2013, respectively.

*Gross Margin:*

Gross profits in the third quarter of 2014 totaled \$5.2 million, or approximately \$0.1 million lower than the third quarter of 2013. Gross profit as a percentage of revenue totaled 18.3% for the three month period ending September 30, 2014, which was 60-basis points below our gross margin performance one-year earlier. The margin compression was due to lower margins on new assignments in our wholesale channel and consultant compensation increases in excess of bill rate increases (particularly in the wholesale IT channel).

Below is a tabular presentation of gross margin by sales channel for the three months ended September 30, 2014 and 2013, respectively:

| <b>Gross Margin</b>         | <b>Three Months Ended<br/>September 30, 2014</b> | <b>Three Months Ended<br/>September 30, 2013</b> |
|-----------------------------|--|--|
| Wholesale IT Channel        | 16.9%  | 18.1%  |
| Retail IT Channel           | 21.8   | 20.8   |
| Permanent Placements / Fees | 100.0  | 100.0  |
| Total gross margin          | 18.3%  | 18.9%  |

Wholesale IT channel gross margins decreased by 120 basis points for the three months ended September 30, 2014 compared to the 2013 period. This decline reflected both lower margins on new assignments with our integrator clients and consultant compensation increases on existing assignments that have out-paced bill rate increases. Retail IT gross margins were up 100 basis points during the three months ended September 30, 2014 compared to the corresponding 2013 period as margins on new MSP assignments continued to strengthen over the last twelve months, partially offset by consultant compensation increases on existing assignments. Additionally, the Company elected not to pursue new business opportunities with a low-margin MSP client in mid-2013, which favorably impacted overall margins in this channel during 2014.

*Selling, General and Administrative ( SG&A ) Expenses:*

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SG&A expenses for the three months ended September 30, 2014 totaled \$3.8 million or 13.2% of revenues, compared to \$3.7 million or 12.9% of revenues for the three months ended September 30, 2013. Fluctuations within SG&A expense components during the 2014 period, compared to a year earlier, included the following:

Sales expense in the 2014 period was flat compared to 2013. Higher salary expense related to our new business development efforts was essentially offset by lower bonus expense.

Recruiting expense in the 2014 period was flat compared to 2013. Higher visa processing fees were offset by a decline in domestic staff and lower bonus expense.

General and administrative expense was up \$0.1 million in 2014 compared to 2013. Higher facility expenses and corporate related costs (legal / outside services) were partially offset by lower bonus expense.

**Table of Contents***Other Income / (Expense) Components:*

Other income / (expense) for the three months ended September 30, 2014 consisted of interest expense of (\$21,000) foreign exchange losses of (\$4,000) and (\$8,000) of losses on the disposal of fixed assets, largely related to the move to our new Corporate Headquarters. For the three months ended September 30, 2013, other income / (expense) consisted of interest expense of (\$23,000) and foreign exchange losses of (\$42,000). The foreign exchange gains and losses were due to fluctuations in the Indian Rupee against the U.S. Dollar.

*Income Tax Expense:*

Income tax expense for the three months ended September 30, 2014 totaled \$527,000, representing an effective tax rate on pre-tax income of 37.5%, compared to \$612,000 for the three months ended September 30, 2013, which represented a 38.0% effective tax rate on pre-tax income. A slightly lower aggregate state tax rate in the 2014 period was responsible for the lower effective tax rate.

***Results of Continuing Operations for the Nine Months Ended September 30, 2014 as Compared to the Nine Months Ended September 30, 2013:****Revenues:*

Revenues for the nine months ended September 30, 2014 totaled \$85.0 million, compared to \$78.4 million for the corresponding nine month period in 2013. This 8% year-over-year revenue increase reflected higher demand for our services and the corresponding increase in billable consultants on assignment during the 2014 period. Partially offsetting this higher demand was a major assignment end in the second quarter of 2014 and a slightly lower average bill rate in the 2014 period compared to one-year earlier.

Below is a tabular presentation of revenues by sales channel for the nine months ended September 30, 2014 and 2013, respectively:

| <b>Revenues (Amounts in millions)</b> | <b>Nine Months Ended<br/>September 30, 2014</b> | <b>Nine Months Ended<br/>September 30, 2013</b> |
|---------------------------------------|---|---|
| Wholesale IT Channel                  | \$ 67.0   | \$ 60.0   |
| Retail IT Channel                     | 17.8  | 18.3  |
| Permanent Placements / Fees           | 0.2   | 0.1   |
| Total revenues                        | \$ 85.0   | \$ 78.4   |

Revenues from our wholesale IT channel increased approximately 12% in the nine month period ended September 30, 2014 compared to the corresponding 2013 period. Higher revenue levels from both staffing clients (up 9%) and integrator clients (up 13%) were driven by stronger demand for IT services. An early project termination at one of our integrator partners during the second quarter of 2014 negatively impacted our nine month 2014 revenue growth rate. Retail IT channel revenues were down approximately 3% during the nine months ended September 30, 2014 compared to the period one-year earlier. The decline reflected lower revenues from direct end-user clients, partially offset by higher revenues from our MSP clients. Permanent placement / fee revenues were up approximately \$0.1 million in the 2014 period compared to the corresponding period in 2013.

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For the nine months ended September 30, 2014, the Company had one client that exceeded 10% of total revenues (Accenture = 11.3%). For the nine months ended September 30, 2013, the Company had one client that exceeded 10% of total revenues (Accenture = 11.1%).

The Company's top ten clients represented approximately 60% and 57% of total revenues for the nine months ended September 30, 2014 and 2013, respectively.

### *Gross Margin:*

Gross profits for the nine months ended September 30, 2014 totaled \$15.6 million, or approximately \$0.9 million higher than the corresponding period of 2013. Gross profit as a percentage of revenue totaled 18.3% for the nine month period ending September 30, 2014, which were 40-basis points below our gross margin performance one-year earlier.

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Below is a tabular presentation of gross margin by sales channel for the nine months ended September 30, 2014 and 2013, respectively:

| <b>Gross Margin</b>         | <b>Nine Months Ended<br/>September 30, 2014</b> | <b>Nine Months Ended<br/>September 30, 2013</b> |
|-----------------------------|---|---|
| Wholesale IT Channel        | 17.1%   | 18.0%   |
| Retail IT Channel           | 21.7  | 20.4  |
| Permanent Placements / Fees | 100.0   | 100.0   |
| Total gross margin          | 18.3%   | 18.7%   |

Wholesale IT channel gross margins decreased by 90 basis points for the nine months ended September 30, 2014 compared to the 2013 period. This decline reflected lower margins on new assignments with our integrator clients and consultant compensation increases on existing assignments that have out-paced bill rate increases. Retail IT gross margins were up 130 basis points during the nine months ended September 30, 2014 compared to the corresponding 2013 period as margins on MSP assignments continued to strengthen over the last twelve months, partially offset by consultant compensation increases on existing assignments. Additionally, the Company elected not to pursue new business opportunities with a low-margin MSP client in mid-2013, which favorably impacted overall margins in this channel during 2014.

*Selling, General and Administrative ( SG&A ) Expenses:*

SG&A expenses for the nine months ended September 30, 2014 totaled \$11.3 million or 13.3% of revenues, compared to \$10.9 million or 13.9% of revenues for the nine months ended September 30, 2013. Fluctuations within SG&A expense components during the 2014 period, compared to a year earlier, included the following:

Sales expense increased in the 2014 period by \$0.2 million compared to 2013. Higher salary expense related to our new business development efforts were partially offset by lower bonus expense.

Recruiting expense in the 2014 period was down \$0.1 million compared to 2013. A slight decline in domestic staff and lower bonus expense were partially offset by higher visa processing fees.

General and administrative expense was up \$0.3 million in the 2014 period compared to 2013. Higher travel and other corporate related expenses (legal / outside services) were partially offset by lower bonus expense.

*Other Income / (Expense) Components:*

Other income / (expense) for the nine months ended September 30, 2014 consisted of interest expense of (\$67,000), foreign exchange gains of \$64,000 and (\$8,000) of losses on the disposition of fixed assets. For the nine months ended September 30, 2013, other income / (expense) consisted of interest expense of (\$77,000) and foreign exchange gains of \$4,000.

*Income Tax Expense:*

Income tax expense for the nine months ended September 30, 2014 totaled \$1.6 million, representing an effective tax rate on pre-tax income of 37.7%, compared to \$1.4 million for the nine months ended September 30, 2013, which represented a 37.7% effective tax rate on pre-tax income.

***Liquidity and Capital Resources:***

*Financial Conditions and Liquidity:*

At September 30, 2014, the Company had cash balances on hand of \$2.5 million, no outstanding debt and approximately \$17.4 million of borrowing capacity under our existing credit facility.

Historically, we have funded our business needs with cash generated from operating activities. Controlling our operating working capital levels by closely managing our accounts receivable balance is an important element of cash generation. At September 30, 2014, our accounts receivable days sales outstanding measurement was 51-days, in-line with historical averages.

The Company believes that cash provided by operating activities, cash balances on hand and current availability under our existing credit facility will be adequate to fund our business needs over the next twelve months.

*Cash flows provided by (used in) operating activities:*

Cash provided by (used in) operating activities for the nine months ended September 30, 2014 totaled \$2.8 million compared to \$1.6 million during the nine months ended September 30, 2013. Elements of cash flows in the 2014 period were net income of \$2.6

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million, non-cash charges of \$0.4 million, and an offsetting increase in operating working capital levels of (\$0.2 million). During the nine months ended September 30, 2013, elements of cash flows were net income of \$2.3 million, non-cash charges of \$0.4 million, and an offsetting increase in operating working capital levels of (\$1.1 million).

Discontinued operations for the nine months ended September 30, 2014 provided \$31,000 of cash, compared to \$1.0 million in the 2013 period. The cash provided in the 2013 period reflected the wind down of retained operating working capital related to the sale of our healthcare staffing business which occurred in August 2013.

### *Cash flows (used in) investing activities:*

Cash (used in) investing activities for the nine months ended September 30, 2014 totaled (\$424,000) compared to (\$64,000) for the nine months ended a year earlier. In both 2014 and 2013, capital expenditures accounted for essentially all of our cash needs. The increase in capital expenditures in the 2014 period reflected the relocation to our new suburban Pittsburgh, PA Headquarters.

In 2013, discontinued operations provided \$1.0 million of cash via the sale of our healthcare staffing business.

### *Cash flows provided by (used in) financing activities:*

Cash (used in) financing activities for the nine months ended September 30, 2014 totaled (\$268,000) and largely consisted of the repurchase of common stock, partially offset by proceeds and excess tax benefits related to the exercise of stock options and vesting of restricted stock and performance shares. Cash (used in) financing activities for the nine months ended September 30, 2013 totaled (\$2.6 million) and largely related to the repayment of short-term borrowings.

### *Contractual Obligations and Off-Balance Sheet Arrangements:*

The Company rents certain office space and equipment under non-cancelable leases which provide for future minimum rental payments. Except for an office lease executed on April 2, 2014 as described in Note 3 Commitments and Contingencies, total lease commitments have not materially changed from the amounts disclosed in the Company's 2013 Annual Report on Form 10-K.

We do not have any off-balance sheet arrangements.

### *Inflation:*

We do not believe that inflation had a significant impact on our results of operations for the periods presented. On an ongoing basis, we attempt to minimize any effects of inflation on our operating results by controlling operating costs and, whenever possible, seeking to ensure that billing rates are adjusted periodically to reflect increases in costs due to inflation.

### *Seasonality:*

Our operations are generally not affected by seasonal fluctuations. However, our consultants' billable hours are affected by national holidays and vacation patterns. Accordingly, we generally have lower utilization rates and higher benefit costs during the fourth quarter. Additionally, assignment completions tend to be higher near the end of the calendar year, which largely impacts our revenue and gross profit performance during the subsequent quarter.



***Recently Issued Accounting Standards:***

Recent accounting pronouncements are described in Note 15 to the accompanying financial statements.

**Table of Contents****ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Cash and cash equivalents are defined as cash and highly liquid investments with maturities of three months or less when purchased. Cash equivalents are stated at cost, which approximates market value.

Our cash flow and earnings are subject to fluctuations due to exchange rate variations. Foreign currency risk exists by nature of our global recruitment centers. We attempt to limit our exposure to currency exchange fluctuations in the Indian rupee ( Rupee ) via the purchase of foreign currency forward contracts. These forward contracts have been designated as cash flow hedging instruments and are used to mitigate overall foreign currency risk by essentially creating offsetting currency exposures. The following table presents information related to foreign currency forward contracts held by the Company as of September 30, 2014:

| Currency (in thousands)    | Amount (in Rupees) | Amount (in USD) |
|----------------------------|--------------------|-----------------|
| Currency Forward Contracts | INR 96,000         | \$ 1,458        |

***Effect of Hypothetical Currency Rate Fluctuations***

As of September 30, 2014, the potential gain or loss in the fair value of the Company's outstanding foreign currency forward contracts assuming hypothetical 10%, 5%, 2% and 1% fluctuations in currency rates would be as follows (amounts in thousands):

|                                      | Valuation given X%         |        |       |       | Fair Value as of September 30, 2014 | Valuation given X%         |       |         |         |
|--------------------------------------|----------------------------|--------|-------|-------|-------------------------------------|----------------------------|-------|---------|---------|
|                                      | decrease in Rupee/USD Rate |        |       |       |                                     | increase in Rupee/USD Rate |       |         |         |
|                                      | 10%                        | 5%     | 2%    | 1%    |                                     | 1%                         | 2%    | 5%      | 10%     |
| Rupee to USD Rate                    | 57.72                      | 60.92  | 62.85 | 63.49 | 64.13                               | 64.77                      | 65.41 | 67.34   | 70.54   |
| Fair value of derivative instruments | \$ 205                     | \$ 118 | \$ 69 | \$ 54 | \$ 39                               | \$ 24                      | \$ 10 | \$ (32) | \$ (97) |

**ITEM 4: CONTROLS AND PROCEDURES*****Disclosure Controls and Procedures***

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934, as amended (the Exchange Act ), is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of Company management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant

to the Exchange Act Rules 13a-15(b) and 15d-15(b). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

The certification required by Section 302 of the Sarbanes-Oxley Act of 2002 are filed as exhibits 31.1 and 31.2, respectively, to this quarterly report on Form 10-Q.

***Changes in Internal Control over Financial Reporting***

There has been no change in Mastech's internal control over financial reporting that occurred during the third quarter that has materially affected, or is reasonably likely to materially affect, such internal control over financial reporting as of December 31, 2013.

Table of Contents**PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

In the ordinary course of our business, we are involved in a number of lawsuits and administrative proceedings. While uncertainties are inherent in the final outcome of these matters, 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.

**ITEM 1A. RISK FACTORS**

There have been no material changes from the risk factors as previously disclosed in our 2013 Annual Report on Form 10-K, filed with the SEC on March 21, 2014.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

A summary of our common stock repurchased during the third quarter of 2014 is set forth in the following table.

| <b>Period</b>                          | <b>Total<br/>Number of<br/>Shares<br/>Purchased (1)</b> | <b>Average<br/>Price per<br/>Share</b> | <b>Total Number<br/>of Shares<br/>Purchased<br/>as<br/>Part of Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>Maximum<br/>Number of<br/>Shares that May<br/>Yet Be<br/>Purchased<br/>Under this<br/>Plan<br/>or Programs<br/>(2)</b> |
|--|---|--|---|---|
| July 1, 2014 - July 31, 2014           | 9,841   | 12.78                                  |   | 517,041   |
| August 1, 2014 - August 31, 2014       | 22,430  | 11.86                                  | 22,430  | 494,611   |
| September 1, 2014 - September 30, 2014 |   |  |   | 494,611   |
| <b>Total</b>                           | <b>32,271</b>   |  | <b>22,430</b>   |   |

- (1) During the three months ended September 30, 2014, the Company purchased 9,841 shares to satisfy employee tax obligations upon the vesting of certain performance shares. These shares were not acquired pursuant to any publicly announced purchase plan or program.
- (2) During the third quarter of 2014, the Company purchased 22,430 shares of common stock pursuant to open market transactions in accordance with its previously announced share repurchase program. As of September 30, 2014, the Company had 494,611 shares available for purchase under this existing program, which is set to expire on December 22, 2014. On October 22, 2014, the Company's Board of Directors voted to extend this program for an additional two year period through December 22, 2016.



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**ITEM 6. EXHIBITS**

(a) Exhibits

- 10.1 Second Amended and Restated Loan Agreement, dated July 11, 2014, by and among Mastech Holdings, Inc., Mastech, Inc., Mastech Alliance, Inc., Mastech Trademark Systems, Inc., and PNC Bank, National Association, is incorporated by reference to Exhibit 10.1 to Mastech's Form 8-K filed on July 17, 2014.
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Chief Executive Officer is filed herewith.
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by the Chief Financial Officer is filed herewith.
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by the Chief Executive Officer is furnished herewith.
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by the Chief Financial Officer is furnished herewith.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this 31st day of October, 2014.

MASTECH HOLDINGS, INC.

October 31, 2014

/s/ D. KEVIN HORNER  
**D. Kevin Horner**  
**Chief Executive Officer**

/s/ JOHN J. CRONIN, JR.  
**John J. Cronin, Jr.**  
**Chief Financial Officer**

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**EXHIBIT INDEX**

|         |  |
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