

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)

**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)

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

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

**1000 Commerce Drive, Suite 500**

**Pittsburgh, PA**  
(Address of principal executive offices)

**15275**  
(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 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 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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**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)

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>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)**

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2012</b>                                 | <b>2011</b> | <b>2012</b>                                | <b>2011</b> |
| 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.

**Table of Contents****MASTECH HOLDINGS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

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

(Unaudited)

|   | September 30, 2012 | December 31, 2011 |
|---|--------------------|-------------------|
| <b>ASSETS</b>   |                    |                   |
| 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               |
| <b>Total current assets</b>   | <b>18,989</b>      | <b>18,903</b>     |
| 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)           |
| <b>Net equipment, enterprise software, and leasehold improvements</b>   | <b>265</b>         | <b>273</b>        |
| Intangible assets, net  | 31                 | 53                |
| Deferred financing costs, net   | 54                 | 74                |
| Goodwill  | 405                | 405               |
| Deferred income taxes   | 205                | 80                |
| <b>Total assets</b>   | <b>\$ 19,949</b>   | <b>\$ 19,788</b>  |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                    |                   |
| 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               |
| <b>Total current liabilities</b>  | <b>7,698</b>       | <b>6,741</b>      |
| <b>Total liabilities</b>  | <b>7,698</b>       | <b>6,741</b>      |
| 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 |                    |                   |
| Additional paid-in-capital  | 38                 | 37                |
| Retained earnings   | 10,383             | 10,114            |
|   | 4,873              | 3,462             |

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|  |           |           |
|--|-----------|-----------|
| 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.

**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>2012</b>                                | <b>2011</b> |
| <b>OPERATING ACTIVITIES:</b>  |  |             |
| 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)       |
| <b>INVESTING ACTIVITIES:</b>  |  |             |
| Capital expenditures  | (126)                                      | (102)       |
| Net cash flows (used in) investing activities   | (126)                                      | (102)       |
| <b>FINANCING ACTIVITIES:</b>  |  |             |
| 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:

| (in thousands)          | As of September 30, 2012 |                          |                    |
|-------------------------|--------------------------|--------------------------|--------------------|
|                         | 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**

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



**Table of Contents****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             | Amount              | Location of         | Amount              | Location of                                  | Amount         |
|----------------------------|---------------------|---------------------|---------------------|--|----------------|
| ASC Topic 815              | of                  | Gain / (Loss)       | of                  | Gain / (Loss)                                | of             |
| Cash Flow                  | Gain / (Loss)       | Gain / (Loss)       | Gain / (Loss)       | Gain / (Loss)                                | Gain / (Loss)  |
| Hedging                    | recognized in OCI   | reclassified from   | reclassified from   | reclassified in                              | recognized     |
| Relationships              | on                  | Accumulated OCI     | to                  | Income                                       | in             |
|                            | Derivatives         | to Income           | Income              | on Derivatives                               | Income         |
|                            | (Effective Portion) | (Effective Portion) | (Effective Portion) | on Derivatives                               | on Derivatives |
|                            |                     |                     | (Effective Portion) | Amounts excluded from effectiveness testing) |                |
| 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             | Amount              | Location of         | Amount              | Location of                                  | Amount         |
|----------------------------|---------------------|---------------------|---------------------|--|----------------|
| ASC Topic 815              | of                  | Gain / (Loss)       | of                  | Gain / (Loss)                                | of             |
| Cash Flow                  | Gain / (Loss)       | Gain / (Loss)       | Gain / (Loss)       | Gain / (Loss)                                | Gain / (Loss)  |
| Hedging                    | recognized in OCI   | reclassified from   | reclassified from   | reclassified in                              | recognized     |
| Relationships              | on                  | Accumulated OCI     | to                  | Income                                       | in             |
|                            | Derivatives         | to Income           | Income              | on Derivatives                               | Income         |
|                            | (Effective Portion) | (Effective Portion) | (Effective Portion) | on Derivatives                               | on Derivatives |
|                            |                     |                     | (Effective Portion) | Amounts excluded from effectiveness testing) |                |
| 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):**

| Derivative Instruments     | September 30, 2012               |            | December 31, 2011      |            |
|----------------------------|----------------------------------|------------|------------------------|------------|
|                            | 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**



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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<br>in<br>Active<br>Markets<br>for<br>Identical Assets<br>(Level<br>1) | Significant<br>other<br>Observable<br>inputs<br>(Level 2) | Unobservable<br>inputs<br>(Level 3) |
| <b>Current Assets:</b>     |   |   |                                     |
| 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<br>September 30,<br>2012 |        | Nine Months Ended<br>September 30,<br>2012 |          |
|-----------------------------|---|--------|--|----------|
|                             | 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<br>September 30,<br>2012 |        | Nine Months Ended<br>September 30,<br>2012 |        |
|--------------------------|---|--------|--|--------|
|                          | 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     |

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|                                  |        |        |        |        |
|----------------------------------|--------|--------|--------|--------|
| 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<br>September 30, 2012 |       | Three Months Ended<br>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<br>September 30, 2012 |       | Nine Months Ended<br>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<br>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**

On December 23, 2010, the Company announced a share repurchase program of up to 750,000 shares of the Company's common stock over a two year period. Repurchases under the program may be made through open market purchases or privately negotiated transactions in accordance with applicable securities laws.

On February 7, 2012, the Company announced that it was commencing a modified Dutch Auction tender offer to repurchase up to 608,000 shares of its common stock (remaining unpurchased shares under its repurchase program), in accordance with Schedule TO, filed with the Securities and Exchange Commission on February 7, 2012. The result of this corporate action was the repurchase of 429,886 shares of the Company's common stock on March 13, 2012, at a price of \$5.79 per share, inclusive of transaction costs. The acquired shares are held in Treasury. The Company repurchased 6,140 shares of its common stock during the three months ended September 30, 2012 at an average price of \$5.05.

**13. Revenue Concentration**

The following table reflects the concentration of revenues of greater than 10% by client for the three and nine months ended September 30, 2012 and 2011:

|                   | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |       |
|-------------------|-------------------------------------|-------|------------------------------------|-------|
|                   | 2012                                | 2011  | 2012                               | 2011  |
| IBM               | 10.2%                               | 14.1% | 12.0%                              | 14.8% |
| Tek Systems       | 10.9%                               | 10.3% | 10.9%                              | 11.0% |
| Kaiser Permanente | 10.3%                               | 9.5%  | 10.7%                              | 9.7%  |

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The Company's top ten clients represented approximately 54% and 54% of total revenues for the three months ended September 30, 2012 and 2011, respectively. For the nine months ended September 30, 2012 and 2011, the Company's top ten clients represented 55% and 58% of total revenues, respectively.

### **14. Related Party Transactions**

The Company transacts with its former parent's affiliate, as indicated below. The Company's Co-Chairmen each have an ownership interest in iGATE Corporation in excess of 10%.

**Table of Contents*****Transactions with iGATE's Affiliate***

Prior to January 1, 2012, iGATE Global Solutions provided the Company with offshore contractors (recruiters) and IT support services. These services were provided under negotiated agreements between the parties. For the three months ended September 30, 2012 and 2011, the Company paid iGATE Global Solutions \$0 and \$229,000, respectively for such services provided. For the nine months ended September 30, 2012 and 2011, the Company paid \$0 and \$641,000 for such services, respectively.

***Accounts Payable with iGATE's Affiliate***

At September 30, 2012 and 2011, the Company had accounts payable balances of \$0 and \$235,000, respectively.

**15. Earnings Per Share**

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

For the three months ended September 30, 2012 and 2011, the computation of diluted earnings per share does not include 50,000 and 251,000 stock options, respectively, as the effect of their inclusion would have been anti-dilutive. For the nine months ended September 30, 2012 and 2011, 50,000 and 250,000 stock options, respectively, were not included in the computation of earnings per share.

**16. Accumulated Other Comprehensive Income (Loss)**

The components of accumulated other comprehensive income (loss) were as follows (in thousands):

|   | September 30, 2012 | December 31, 2011 |
|---|--------------------|-------------------|
| Net unrealized gain on cash flow hedge (net of taxes) | \$ 45              | \$                |

**17. Severance Charges**

The Company incurred severance costs of \$0 and \$120,000 during the three and nine months ended September 30, 2012, respectively, related to a change in executive leadership. During the three and nine months ended September 30, 2011, the Company incurred \$0 and \$100,000 of severance costs related to its realignment of roles within its recruitment organization. These costs are included as selling, general and administrative expense in the Company's Condensed Consolidated Statements of Operations.

**18. Subsequent Events**

On October 23, 2012, the Board of Directors approved the extension of the Company's existing share repurchase program through December 22, 2014 and increased the number of shares subject to the program by 250,000 shares. This program was set to expire on December 22, 2012. As of September 30, 2012, there were 171,088 shares subject to purchase under this program.

**19. Recently Issued Accounting Standards**

The Company is of the opinion that any pending accounting pronouncements, either in the adoption phase or not yet required to be adopted, will not have a significant impact on the Company's financial position or results of operations.



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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 included in our Annual Report on Form 10-K for year ended December 31, 2011, filed with the Securities and Exchange Commission ( SEC ) on March 23, 2012.

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 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 2011 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 2011 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.

#### ***Overview:***

We are a domestic provider of IT and specialized healthcare staffing services. From July 1986 through September 2008, 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 eBusiness 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. Our healthcare staffing unit provides specialized healthcare professionals to hospitals and other healthcare facilities.

The Company aggregates its IT and healthcare operating segments based on the nature of services and, accordingly, has one reportable segment. Thus, no segment related disclosures are presented. However, the Company tracks and evaluates its revenues and gross profits by four distinct sales channels: wholesale IT; retail IT; specialized healthcare 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 ). The specialized healthcare channel clients consist of hospitals and other healthcare facilities that utilize our staffing professionals. Permanent placement / fee revenues are incidental revenues derived as by-product opportunities of conducting our core contract staffing business.

#### ***Critical 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 transaction affects earnings. Changes in the fair value of

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these instruments deemed ineffective are recognized in the Consolidated Statement of Operations as foreign exchange gains (losses). 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).

With respect to derivatives designated as hedges, the Company formally documents all relationships between the hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking such transactions. 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 gain (loss).

**Other Critical 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.

***Recent Developments:***

On October 23, 2012, the Board of Directors approved the extension of the Company's existing share repurchase program through December 22, 2014 and increased the number of shares subject to the program by 250,000 shares. This program was set to expire on December 22, 2012.

***Economic Trends and Outlook:***

Generally, our business outlook is highly correlated to 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 last 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 and during the first nine months of 2012, activity levels have continued to trend up in most technologies and sales channels. Notwithstanding this recent trend, we continue to have concerns about U.S. economic conditions due to lingering uncertainties that exist in the global economy as we look towards the fourth quarter of 2012 and into 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. Should this trend in our business mix continue, it is likely that our overall gross margins will decline. 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. The impact of this shift towards the MSP model has been lower gross margins. Should this trend towards utilizing the MSP model continue, it is likely that our gross margins will decline in the future.

***Results of Operations for the Three Months Ended September 30, 2012 as Compared to the Three Months Ended September 30, 2011:***

***Revenues:***

Revenues for the three months ended September 30, 2012 totaled \$25.6 million, compared to \$23.5 million for the corresponding three month period in 2011. This 9% year-over-year revenue increase largely reflects a higher demand for our services and the corresponding increase in IT billable consultants during the 2012 period, as well as the expansion of our healthcare business. Billable IT headcount at September 30, 2012 totaled 633 consultants compared to 542 consultants, a year earlier. For the three-month period ended September 30, 2012 our billable IT headcount increased by 46-consultants or an increase of approximately 8%.

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Below is a tabular presentation of revenues by sales channel for the three months ended September 30, 2012 and 2011:

| Revenues (Amounts in millions) | Three months<br>ended | Three months<br>ended |
|--------------------------------|-----------------------|-----------------------|
|                                | September 30, 2012    | September 30, 2011    |
| Wholesale IT Channel           | \$ 16.2               | \$ 15.0               |
| Retail IT Channel              | 6.5                   | 5.9                   |
| Specialized Healthcare         | 2.8                   | 2.4                   |
| Permanent Placements / Fees    | 0.1                   | 0.2                   |
| <b>Total revenues</b>          | <b>\$ 25.6</b>        | <b>\$ 23.5</b>        |

Revenues from our wholesale IT channel increased approximately 8% during the three month period ended September 30, 2012 compared to the corresponding 2011 period. Higher revenue levels from staffing clients (up 28%) were driven by stronger demand for IT services. Partially offsetting this increase were lower integrator client revenues (down 6%) as lower levels of new ERP assignments have impacted this channel's performance in 2012. Retail IT channel revenues were up approximately 10% during the three months ended September 30, 2012 compared to the period a year earlier due to higher demand at many of our MSP clients. Specialized healthcare revenues increased by 17% for the three month 2012 period compared to the corresponding 2011 period. This improvement largely reflects the expansion of our therapy service offerings during the current year. Permanent placement / fee revenues were approximately \$0.1 million down from revenues generated a year earlier.

During the three months ended September 30, 2012, we had three clients that represented more than 10% of total revenues (TEK Systems = 10.9%; IBM = 10.2%; and Kaiser Permanente = 10.3%). During the three months ended September 30, 2011, we had two clients that represented more than 10% of total revenue (IBM = 14.1% and TEK Systems = 10.3%). During the 2012 period, our top ten clients represented approximately 54% of total revenues compared to 54% of total revenues in the corresponding 2011 period.

*Gross Margin:*

Gross profits in the third quarter of 2012 totaled \$4.9 million, or approximately \$0.2 million higher than the third quarter of 2011. Gross profit as a percentage of revenue was 19.1% in the three-month period ending September 30, 2012, which was in-line with the results for the second quarter 2012. However, these margins were below the 19.8% achieved during the corresponding three month period ending September 30, 2011. The gross margin decline from a year earlier reflected supply-side pricing pressures within certain technologies, a revenue shift towards our lower margin sales channels and lower ERP and permanent placement revenues.

Below is a tabular presentation of gross margin by sales channel for the three months ended September 30, 2012 and 2011:

| Gross Margin                | Three months<br>ended | Three months<br>ended |
|-----------------------------|-----------------------|-----------------------|
|                             | September 30, 2012    | September 30, 2011    |
| Wholesale IT Channel        | 18.7%                 | 18.9%                 |
| Retail IT Channel           | 19.4                  | 19.8                  |
| Specialized Healthcare      | 17.7                  | 20.1                  |
| Permanent Placements / Fees | 100.0                 | 100.0                 |
| <b>Total gross margin</b>   | <b>19.1%</b>          | <b>19.8%</b>          |

Wholesale IT channel gross margins declined by 20 basis points for the three months ended September 30, 2012 compared to the corresponding 2011 period. This decline largely reflected lower margins at our staffing clients as consultant compensation increases on existing assignments exceeded our ability to secure bill rate increases. Additionally, a lower level of ERP assignments at our integrator clients also impacted margins. Retail IT gross margins were down 40 basis points during the three months ended September 30, 2012 compared to 2011, due to supply-side pricing pressures and an unfavorable mix of business between direct end-user and MSP clients. Specialized healthcare gross margins declined by 240 basis points in the 2012 period compared to a year earlier. This decline reflects pricing pressures from MSP clients and an unfavorable mix

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of business related to the Company's healthcare service offerings during the 2012 quarter.

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

SG&A expenses for the three months ended September 30, 2012 totaled \$3.9 million or 15.4% of revenues, compared to \$3.9 million or 16.7% of revenues for the three months ended September 30, 2011. Our level of SG&A spend in the current quarter was \$0.1 million less than in the previous quarter ended June 30, 2012, as selling expenses declined. This decline should be viewed as temporary given our plans to expand the sales organization over the next several quarters. Fluctuations within SG&A expense components during the 2012 period compared to a year earlier included the following:

Sales expense was lower by \$0.2 million in the 2012 period compared to 2011 due to lower sales leadership expenses.

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Recruiting expense was up in the 2012 period by \$0.2 million due to an increase in recruiting staff and higher visa processing/job board fees.

General and administrative expense in 2012 was in-line with expenses a year earlier.

*Other Income / (Expense) Components:*

Other Income / (Expense) for the three months ended September 30, 2012 consisted of interest expense of \$17,000; and foreign exchange gains of \$52,000. For the three months ended September 30, 2011, Other Income / (Expense) consisted of interest expense of \$9,000, foreign exchange losses of \$6,000 and a \$3,000 loss related to the closure of a joint venture. The higher interest expense in the 2012 period largely reflects the amortization of deferred financing costs related to our August 31, 2011 amended credit facility with PNC Bank. The foreign exchange gains reflect a \$30,000 gain on our foreign currency forward contracts and gains related to the strengthening of the Indian rupee against the U. S. Dollar during the three-months ended September 30, 2012.

*Income Tax Expense:*

Income tax expense for the three months ended September 30, 2012 totaled \$374,000 representing an effective tax rate on pre-tax income of 38.4%, compared to \$269,000 for the three months ended September 30, 2011, which represented a 37.9% effective tax rate on pre-tax income.

**Results of Operations for the Nine Months Ended September 30, 2012 as Compared to the Nine Months Ended September 30, 2011:***Revenues:*

Revenues for the nine months ended September 30, 2012 totaled \$75.4 million, compared to \$65.5 million for the corresponding nine month period in 2011. This 15% year-over-year revenue increase largely reflects a higher demand for our services and the corresponding increase in billable consultants during the 2012 period.

Below is a tabular presentation of revenues by sales channel for the nine months ended September 30, 2012 and 2011:

| <b>Revenues (Amounts in millions)</b> | <b>Nine months<br/>ended<br/>September 30, 2012</b> | <b>Nine months<br/>ended<br/>September 30, 2011</b> |
|---------------------------------------|---|---|
| Wholesale IT Channel                  | \$ 47.1   | \$ 42.4   |
| Retail IT Channel                     | 20.0  | 16.4  |
| Specialized Healthcare                | 8.1   | 6.3   |
| Permanent Placements / Fees           | 0.2   | 0.4   |
| <b>Total revenues</b>                 | <b>\$ 75.4</b>                                      | <b>\$ 65.5</b>                                      |

Revenues from our wholesale IT channel increased approximately 11% during the nine month period ended September 30, 2012 compared to the corresponding 2011 period. Higher revenue levels from staffing clients (up 30%) were driven by stronger demand for IT services. During the 2012 period, lower levels of new ERP assignments have impacted the growth of our integrator business which was flat when compared to the 2011 period. Retail IT channel revenues were up approximately 22% during the nine months ended September 30, 2012 compared to the period a year earlier. This increase came from higher demand at many of our MSP clients. Specialized healthcare revenues increased by 29% for the nine month 2012 period compared to the corresponding 2011 period. This improvement reflected an expansion of our service offerings and the geographies in which we market such services. Permanent placement / fee revenues were approximately \$0.2 million below those revenues generated a year earlier.

During the nine months ended September 30, 2012, we had three clients that represented more than 10% of total revenues (IBM = 12.0%; TEK Systems 10.9%, and Kaiser Permanente = 10.7%) During the nine months ended September 30, 2011, we had two clients that represented more than 10% of total revenue (IBM = 14.8% and TEK Systems = 11.0%). During the 2012 period, our top ten clients represented approximately 55% of total revenues compared to 58% of total revenues in the corresponding 2011 period.

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### *Gross Margin:*

Gross profits in the first nine months of 2012 totaled \$14.2 million, or approximately \$1.2 million higher than during the first nine months of 2011. Gross profit as a percentage of revenue declined to 18.8% in the nine-month period ending September 30, 2012 from the 19.7% reported in the corresponding 2011 period. This reduction in gross margin reflected supply-side pricing pressures within certain technologies, a revenue shift towards our lower margin sales channels, and lower ERP and permanent placements revenues in the 2012 period.

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Below is a tabular presentation of gross margin by sales channel for the nine months ended September 30, 2012 and 2011:

| <b>Gross Margin</b>         | <b>Nine months<br/>ended<br/>September 30, 2012</b> | <b>Nine months<br/>ended<br/>September 30, 2011</b> |
|-----------------------------|---|---|
| Wholesale IT Channel        | 18.2%   | 18.8%   |
| Retail IT Channel           | 19.4  | 20.5  |
| Specialized Healthcare      | 18.1  | 18.7  |
| Permanent Placements / Fees | 100.0   | 100.0   |
| <b>Total gross margin</b>   | <b>18.8%</b>  | <b>19.7%</b>  |

Wholesale IT channel gross margins declined by 60 basis points for the nine months ended September 30, 2012 compared to the corresponding 2011 period. This decline was due to lower levels of ERP assignments and consultant compensation increases, in excess of bill rate increases, on existing projects in the 2012 period. Retail IT gross margins were down 110 basis points during the nine months ended September 30, 2012 compared to 2011, due to supply-side pricing pressures and an unfavorable mix of business between direct end-user and MSP clients. Specialized healthcare gross margins declined by 60 basis points in the 2012 period compared to a year earlier, largely due to an unfavorable mix of business (service offerings) and pricing pressures from MSP clients during the third quarter of 2012.

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

SG&A expenses for the nine months ended September 30, 2012 totaled \$11.9 million or 15.7% of revenues, compared to \$11.5 million or 17.6% of revenues for the nine months ended September 30, 2011. The increase in SG&A expenses largely reflected investments made to our recruiting organization, particularly during the first six months of 2012. Fluctuations within SG&A expense components during the 2012 period compared to a year earlier included the following:

Sales expense was down \$0.3 million in the 2012 period compared to 2011, largely due to lower sales leadership expenses.

Recruiting expense was up in the 2012 period by \$0.7 million due to an increase in recruiting staff, higher visa processing / job board fees and expenditures made in connection with process improvement initiatives.

General and administrative expense in 2012 was in-line with expenses incurred a year earlier. Both the 2012 and 2011 periods included approximately \$0.1 million of severance expense related to sales and recruitment leadership changes.

*Other Income / (Expense) Components:*

Other Income / (Expense) for the nine months ended September 30, 2012 consisted of interest expense of \$ 50,000; and foreign exchange gains of \$29,000. For the nine months ended September 30, 2011, Other Income / (Expense) consisted of interest expense of \$21,000, foreign exchange losses of \$6,000 and a \$5,000 loss related to the closure of a joint venture. The higher interest expense in the 2012 period largely reflects the amortization of deferred financing costs related to our August 31, 2011 amended credit facility with PNC Bank. The foreign exchange gains reflect a \$30,000 gain related to our currency forward contracts used to hedge currency fluctuations in the Indian Rupee.

*Income Tax Expense:*

Income tax expense for the nine months ended September 30, 2012 totaled \$875,000, representing an effective tax rate on pre-tax income of 38.3%, compared to \$523,000 for the nine months ended September 30, 2011, which represented a 37.8% effective tax rate on pre-tax income.

*Liquidity and Capital Resources:**Financial Conditions and Liquidity:*

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At September 30, 2012, we had \$3.3 million of cash and equivalents on hand. In addition to our cash balances, we have access to a credit facility with PNC Bank, N.A. with \$19 million of maximum availability, under which our borrowing base was \$15.0 million as of September 30, 2012.

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, 2012, our accounts receivable days sales outstanding ( DSO s ) measurement was 51-days, which was 1-day higher than our DSO s of a year ago. We expect cash provided by operating activities, cash balances on hand and access to capital under our existing credit facility to be adequate to fund our business needs over the next 12-months.



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

Cash provided by operating activities for the nine months ended September 30, 2012 totaled \$37,000 compared to cash used of (\$0.2 million) during the nine months ended September 30, 2011. Elements of cash flows during the 2012 period were net income of \$1.4 million, non-cash charges of \$0.3 million and an offsetting increase in operating working capital levels of (\$1.7 million). During the nine months ended September 30, 2011, elements of cash flows included net income of \$0.9 million, non-cash charges of \$0.3 million and an offsetting increase in operating working capital levels of (\$1.4 million). The increases in operating working capital levels in both periods were in support of our revenue growth.

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

Cash used in investing activities for the nine months ended September 30, 2012 totaled \$126,000 compared to \$102,000 for the nine months ended a year earlier. In both 2012 and 2011, capital expenditures accounted for our entire cash needs.

### *Cash flows used in financing activities:*

Cash used in financing activities for the nine months ended September 30, 2012 totaled \$2.4 million and largely related to common shares purchased under the Company's modified Dutch Auction tender offer in March 2012. In the 2011 period, cash used in financing activities totaled \$0.5 million and related to common shares purchased under the Company's share repurchase program and deferred financing costs incurred in connection with our amended credit facility with PNC Bank.

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

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.

### *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 insure 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 policies. Accordingly, we generally have lower utilization rates and higher benefit costs during the fourth quarter.

### *Recently Issued Accounting Pronouncements:*

The Company is of the opinion that any pending accounting pronouncements, either in the adoption phase or not yet required to be adopted, will not have a significant impact on the Company's financial position or results of operations.

## **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 flows and earnings are subject to fluctuations due to exchange rate variations. Foreign currency risk exists by the nature of our Indian-based recruitment centers. We attempt to limit our exposure to currency exchange fluctuations in the Indian Rupee ( Rupee ) via the purchase of forward currency exchange contracts. These forward contracts have been designated as cash flow hedging instruments and are used to mitigate overall 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, 2012:

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| <b>Currency (in thousands)</b> | <b>Amount (in Rupees)</b> | <b>Amount (in USD)</b> |
|--------------------------------|---------------------------|------------------------|
| Currency Forward Contracts     | 81,000                    | \$ 1,401               |

**Table of Contents*****Effect of Hypothetical Currency Rate Fluctuations***

As of September 30, 2012, 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%<br>decrease in Rupee/USD Rate |        |        |        | Fair Value<br>as of<br>September 30, 2012 | Valuation given X%<br>increase in Rupee/USD Rate |       |       |         |
|--------------------------------------|--|--------|--------|--------|---|--|-------|-------|---------|
|                                      | 10%  | 5%     | 2%     | 1%     |   | 1%   | 2%    | 5%    | 10%     |
| Rupee to USD Rate                    | 48.57  | 51.27  | 52.89  | 53.43  | 53.97                                     | 54.51  | 55.05 | 56.67 | 59.37   |
| Fair value of derivative instruments | \$ 267   | \$ 179 | \$ 130 | \$ 115 | \$ 100                                    | \$ 85  | \$ 70 | \$ 28 | \$ (37) |

**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 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 Securities Exchange Act of 1934 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, 2011.

**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 2011 Annual Report on Form 10-K, filed with the SEC on March 23, 2012.

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

A summary of our common stock repurchased during the third quarter of 2012 under the 750,000 share repurchase program authorized by our Board of Directors and publicly announced on December 23, 2010, is set forth in the following table.

| Period                                 | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price per<br>Share | Total Number<br>of Shares<br>Purchased<br>as<br>Part of Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number of<br>Shares that May<br>Yet Be<br>Purchased<br>Under this<br>Plan<br>or Programs |
|--|---|-------------------------------|---|---|
| July 1, 2012 - July 31, 2012           |   | \$                            |   | 177,228   |
| August 1, 2012 - August 31, 2012       |   |                               |   | 177,228   |
| September 1, 2012 - September 30, 2012 | 6,140                                     | \$ 5.05                       |   | 171,088   |
| Total                                  | 6,140                                     | \$ 5.05                       |   |   |

This repurchase program was set to expire on December 22, 2012. However, on October 23, 2012, our Board of Directors amended our existing share repurchase program increasing the number of shares authorized to be purchased under the program by 250,000 shares and extending the duration of the program for an additional two years through December 22, 2014.

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**ITEM 6. EXHIBITS**

(a) Exhibits

|          |   |
|----------|---|
| 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 filed 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 filed herewith. |
| 101.INS* | XBRL Instance Document.   |
| 101.SCH* | XBRL Taxonomy Extension Schema Document.  |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document.  |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document.  |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document.   |

\* XBRL (eXtensible Business Reporting Language) information is furnished and not filed herewith, is not part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to the liability under these sections.

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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 9th day of November, 2012.

MASTECH HOLDINGS, INC.

November 9, 2012

/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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