BigBear.ai Second Quarter 2022 Earnings Call Transcript August 9, 2022

Presenters
Dr. Reggie Brothers, CEO
Josh Kinley, Chief Corporate Development Officer
Julie Peffer, CFO
Jeff Dyer, President of Commercial

Q&A Participants
Louie DiPalma – William Blair
Mike Latimore – Northland Capital Markets
Michael Cho – Marathon Asset Management

Operator
Thank you for joining the BigBear.ai Second Quarter 2022 conference call. This call is being recorded. And at this time, all participants are in a listen-only mode and a question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero, on your telephone keypad.

I will now turn the call over to Josh Kinley of BigBear.ai. Please go ahead, Mr. Kinley.

John Kinley
Good afternoon, everyone, and welcome to BigBear.ai's 2022 Second Quarter Earnings Conference Call. I'm Josh Kinley, the former CFO and now Chief Corporate Development Officer BigBear.ai. I'm here with Dr. Reggie Brothers, CEO, and Julie Peffer, our new CFO who joined the Company in June.

During the call today, we may make certain forward-looking statements. Listeners are cautioned not to put undue reliance on the forward-looking statements, and BigBear.ai specifically disclaims any obligation to update the forward-looking statements that may be discussed during this call. Many factors could cause actual events to differ materially from the forward-looking statements made on the call. These statements are based on current expectations and assumptions, and as a result are subject to risks and uncertainties. For more information about these risks and uncertainties, please refer to the forward-looking statements section of the earnings press release issued today and our SEC filings.

We will also discuss some non-GAAP financial measures during the call today. These non-GAAP financial measures should not be considered a replacement for and should be read together with GAAP results. You can find the GAAP and non-GAAP reconciliations within our earnings release.

Now, I'd like to turn the call over to Reggie.

Reggie Brothers
Thank you, Josh, and thank you all for joining the call.

BigBear.ai is in the early stages of a transformation. We're evolving our successful services-led business into a high-growth, high-margin, technology-led company that empowers customers to make the right decisions at the right time, using AI powered analytics. This is a multi-year process and requires aggressive investments in people, products, and infrastructure to achieve scalable growth. It also requires maturation, to operate as a public company effectively and efficiently.

Despite some challenging circumstances affecting our second-quarter results and outlook for the rest of the year, we continue to have a strong foundational business with significant backlog. And we remain confident in our ability to transform and deliver on our vision. As you likely have seen in the in earnings announcement issued today, our second-quarter performance did not propel us forward at the pace we had anticipated. Externally, the war in Ukraine and the slowing U.S. economy created delays in revenue we were expecting in the quarter. Internally, we increased spend in Q2 to support our growth, as well as governance requirements as a public company, both of which reduced our operating margin and cash reserves.

Based on these circumstances and their expected impact on our 2022 financial model, we are taking a more conservative approach to our revenue forecast and operating expenses for the remainder of the year and recalibrating our guidance accordingly. Julie will provide more details on these changes later in the call.

First, I'd like to provide more color on our customer engagements and how we are responding to market dynamics, starting with our government contracts. The flow of funds from the appropriations bill signed in March continues to work its way through individual agencies and projects, but we have also experienced delays in the contracting process due to the focus on the war in Ukraine. Unfortunately, this has delayed the timing on some anticipated contract awards in our near-term pipeline.

To be clear, we continue to see strong demand for our products and services with our federal customers. But the timing associated with some of this revenue has become increasingly difficult to predict, given the current geopolitical and economic climate. Importantly, while the uncertain timing of contract awards is frustrating, the government's fundamental need for our solutions and the value of the relationships they enable us to build are enduring.

Further, we have historically supported and included in our forecast and backlog certain lower margin procurement activities on behalf of our customers to foster long-term relationships. However, irregularity of this revenue introduces lumpiness in our projections and margin pressure. Therefore, we are no longer including certain anticipated awards of this type in our

2022 forecast, which is reflected in our revised guidance as Julie will describe. Similarly, Julie will explain the more conservative approach we are taking to calculate our backlog into Q2 and going forward.

With some government funding being diverted to Ukraine, we believe it is prudent to reduce our estimates within certain categories of our backlog. Despite the lower numbers reflected in our earnings under the new calculations, our firm backlog has increased by approximately 70% over the last 18 months. And we believe it reflects continued strong demand for our products, services, and solutions.

We further believe, as a result of these changes, our projections will be more predictable and will better reflect our strategic engagements and focus on building a higher-margin business over the long term. While the current geopolitical environment is delaying the timing of new deals, it also highlights the need for advanced AI and cyber solutions that provide enhanced intelligence and threat protection, areas where we have an outstanding track record of success in highly complex environments.

We continue to perform well on prototype projects in these areas. In fact, our team was awarded first place at the U.S. Cyber Command Prototyping Event held in June, highlighting BigBear.ai as a leader in AI/ML full-spectrum cyber technology. This is just one of several new prototypes we developed and demonstrated in the second quarter that resulted in accelerated production phases for large contracts, invitations to participate in new military exercises, and expanded business development relationships introducing us to new customers.

Although prototype work frequently incurs significant upfront investments with very low or even negative margins, they have the potential to lead to significant multi-year contracts with much better margins. We expect to see new awards associated with our latest prototypes beginning this month and continuing through 2023. We also expect the increase in funds earmarked for AI adoption in the defense budget to generate more opportunities for us with current and new government customers well into the future.

With a growing pipeline for both our Cyber & Engineering business, as well as our Analytics business, we continue to be well-positioned to drive growth and capture larger technology-led projects with government customers.

Now, I'd like to address our progress with ProModel. During the Q1 earnings call, I mentioned that mergers and acquisitions would be a key part of our growth strategy this year, allowing us to accelerate our product roadmap and entry into rapidly growing markets. The ProModel acquisition that occurred in Q2 is a great example of this strategy at work. This accretive acquisition has enriched our portfolio with advanced modeling and simulation products and has given us a foothold in the high-growth manufacturing and healthcare markets.

For example, our FutureFlow RX product for the healthcare sector provides a simulation platform for patient flow and hospital capacity, helping hospitals to predict patient loads, optimize patient care, and improve financial performance. In the second quarter, we signed a new deal with one of the largest healthcare systems in the eastern United States, and we are seeing rapid growth in our pipeline, as hospitals and healthcare centers continue to feel the effects of COVID and a shortage of healthcare workers.

We are seeing similar demand in shipyard operations, domestically and abroad, as shipbuilding and repair facilities struggle with intense challenges in capacity planning and resource utilization. Our ability to integrate AI-powered analytics with a digital twin of production processes dramatically improves forecasting accuracy, yard optimization, and operational efficiency for our customers. These benefits are clickable across a wide range of industrial and discrete manufacturing processes, and we are working to extend our Shipyard AI product to address more segments of the global supply chain.

These examples demonstrate just a fraction of the opportunities gained from the acquisition of ProModel. The integration from both a business and technical perspective is on track, and we are building relationships with our expanded customer base and partner network, which we will leverage to expand into new markets and geographies in 2023 and beyond. Although our commercial sales cycles are moving more slowly due to economic uncertainty, we are pleased with our bookings to date, and we expect to see a positive impact on revenue in the back half of this year, with significantly more impact next year, as is common with subscription-based offerings.

Before turning the call over to Julie, I'd like to briefly address our operating expenses. As I mentioned earlier, we leaned forward in our investment strategy during the second quarter to support our requirements as a public company and to fuel future growth. Many of these investments, such as the acquisition of ProModel and our growing commercial go-to-market organization, will help us transition our business to steadier, more predictable and higher-margin SaaS business contracts in the future.

However, in light of the unexpected delays in revenue and longer sales cycles we are seeing as a result of the slowed economy, we are taking a more stringent approach to reducing operating expenses and conserving cash for the remainder of this year.

Increasing operational efficiency is a core component of our transformation and maturation process. It is also one of many strengths that make Julie Peffer, our new CFO, a great addition to our executive team. Julie brings 20 years of experience building and running mature, efficient finance departments and other G&A functions for global public companies like AWS, FlowServe, Raytheon, and many others. She's well-versed in government contracting processes, healthcare, and manufacturing industries, and SaaS subscription business models. She'll be instrumental in helping BigBear.ai improve our operating efficiency, forecasting fidelity, and governance capabilities, as we plan and execute our aggressive growth and transformation strategy.

With that, I am pleased to turn the call over to Julie to provide more details on our Q2 earnings and recalibrated guidance for the remainder of the year. Julie?

Julie Peffer

Thank you, Reggie. I'm excited to be here on my first earnings call as the Chief Financial Officer of BigBear.ai, and to help guide the Company through our exciting transformation. As Reggie said, our aggressive growth strategy must be balanced by disciplined investments, operational efficiency, and diligent governance. And these are all areas where I believe my experience and expertise can help accelerate the Company's maturation and improve our financial performance.

Now let's turn to the results for the second quarter. Revenue for the quarter was $37.6 million compared to $36.3 million in the second quarter of 2021, driven by execution of the contracts in our backlog and growing commercial engagement. Approximately $19 million of revenue from our Analytics Segment compared to $16 million in the prior year. The 18% increase is largely attributable to an expansion of key programs from awards won in 2021, as well as commercial revenue growth from the addition of ProModel.

While the slowing economy has elongated sales cycles with current and new customers, we expect the portion of our revenue attributed to higher-margin analytics to continue growing, and this quarter is a great reflection of the shift in our business model.

$18.6 million of revenue came from the Cyber and Engineering or C&E business, compared to $20.3 million in the prior-year period. The lower revenue was largely the result of the lumpy procurement activity that Reggie mentioned earlier. In general, services contracts are especially susceptible to priority changes, underscoring our need to sharpen our focus on more reliable, long-term software-related engagement.

Our backlog remains healthy, coming in at $325 million at the end of the quarter. This reduction versus prior quarter reflects two changes in our approach to backlog reporting, not a loss in contractual work. Previously, our backlog included five categories: funded backlog, unfunded backlog, priced unexercised options, unpriced unexercised options, and anticipated follow-on awards.

Historically, anticipated follow-on awards were added to backlog when a customer notified us that a program we currently support would be continuing under a new contract. Given our remarkably high track record of winning re-compete business, these notifications were considered highly reliable. However, due to the delays we have experienced with the contracting of these follow-on awards, we've decided to remove this category from our backlog calculation and keep these follow-on contracts as part of our pipeline until they are contracted.

The second change to our backlog group pertains to our unpriced, unexercised backlog, which we have reassessed in light of the geopolitical environment. While we still have this work under contract, we've reduced our estimates to reflect more recent funding trends, such as diversion of funds to Ukraine or other unforeseen project disruption. To be clear, we have not lost contractual work. We are simply taking a more conservative approach in our estimates of what will be funded in the future on our existing contracts.

To give you a better sense of how backlog is trending, if we apply our revised approach to the Q1 backlog, our second-quarter backlog would be 5% higher than last quarter. In addition, as Reggie stated, our firm backlog which consists of funded, unfunded, and priced unexercised options has increased by approximately 70% since December 2020. This significant growth highlights our strength in converting our pipeline into signed and priced contracts.

In the second quarter, our gross margin was 25% on a GAAP basis. Our segment adjusted gross margin in Analytics was 39%, compared to 46% for the prior-year period. This change was a direct result of our participation in various prototype projects that Reggie mentioned, where federal customers request lengthy demonstrations prior to committing to large multi-year deals. Historically, we have a very high success rate on these engagements, but the near-term impact on margin is evident. Our segment adjusted gross margin in Cyber & Engineering was 24% for the quarter, 2 percentage points higher than 22% adjusted gross margin reported in the second quarter of 2021, due to the mix shift of lower procurement activity this year compared to last.

On a consolidated basis, adjusted gross margin was 32%, which is flat year-over-year, due to the prototype investments previously discussed. We continue to see growth in our Analytics business with both federal and private sector customers, and we expect to see margins increasing significantly over time.

Additionally, earnings were impacted by a higher level of operating expenses linked to R&D, transaction and integration costs related to the ProModel acquisition, and our go-to-market strategy in commercial. Excluding a non-cash goodwill impairment charge of $35.3 million related to our Cyber & Engineering segment in the quarter, operating expenses were $29.7 million in the second quarter, including R&D expenses of $2.5 million and SG&A expenses of $26.9 million. The increase in SG&A was primarily driven by equity-based compensation costs, increased people and IT costs, and new public company requirements.

For the second quarter, we posted a net loss of $56.8 million, primarily driven by the goodwill impairment charge of $35.3 million and the increased operating expenses in growth investments I just described. The goodwill impairment assessment was conducted primarily because of the lower assumed growth rate due to the customer contracting delays and macroeconomic factors we have discussed,and the charge was recorded in the Cyber & Engineering segment. Adjusted EBITDA was negative $7.7 million for the second quarter, also driven by the delayed contract awards and our continued investments.

Now turning to the balance sheet. We had cash and cash equivalents of approximately $30 million at the end of the quarter. Due to the ProModel acquisition, cash burn was abnormally high in Q2. And we are in the process of conducting a rigorous and disciplined assessment of our cost structure, and going forward, we expect to significantly reduce our cash burn through aggressive cost savings initiatives, streamlining operations, and fully integrating as one business. We expect to provide an update on our progress during our third-quarter call.

Now turning to our outlook. As Reggie mentioned, there are procurement elements of our historical business that are lumpy by nature, low margin, and difficult to forecast. In addition, the current geopolitical and economic climate has lengthened the contracting process and made the timing of certain follow-on awards even more difficult to predict. Therefore, we are removing this business from our forecast and revising our outlook accordingly. We will continue to support our customer procurement requests as needs arise, but we believe it's prudent to handle these projects as outliers, due to their unpredictable nature. And this change gives us an appropriate, conservative view of our core business today.

As a result of these factors, we now expect revenue for 2022 to be approximately $150 to $170 million. In our Commercial business, we anticipate gaining more traction as we complete ProModel integration in the second half of the year, and we expect our commercial revenue to comprise approximately 10% of our second-half total revenue.

Due to the external challenges affecting revenue growth and losses experienced in the first half of the year, we expect adjusted EBITDA to be negative. Factoring in our aggressive cost reduction plans, which include targeted reductions in SG&A and more focused strategic investments required for growth, we expect significantly reduced losses, with single-digit negative millions in EBITDA in the second half of the year.

Looking ahead, as Reggie stated, we are taking a more rigorous approach to our capital allocation and expense management processes to improve our operating efficiency while pursuing profitable, strategic growth. Our full-year revenue and gross margins are increasing year-over-year, and our backlog remains strong. While we continue to invest in our product strategy and commercial go-to-market efforts, we will focus on driving greater synergy from acquired companies and increased efficiencies within our larger operating model.

And with that, I'll turn it back over to Reggie for closing remarks.

Reggie Brothers
Thanks, Julie. As you heard in Julie's report, we are still growing despite the challenging current climate. We are focused on rigorously managing our expenses and cash position as we make the disciplined investments needed to accelerate our growth.

We also have made substantial progress in our transition to become a more scalable, profitable, technology-first company. And we have high confidence in the recalibrated guidance we have presented today.

While we expect Ukraine aid to continue to be a priority for the federal government in the near-term, we do anticipate increased government award and contract activity in the back half of the year. We are also ramping our commercial business with ProModel, establishing footholds in our strategic markets, and growing our pipeline of opportunities substantially.

Across both government and commercial, we continue to see tremendous market opportunity on the horizon. So, while the changes to our near-term outlook are necessary given the macroeconomic factors at play right now, our revised 2022 guidance is not representative of our successful track record – evidenced by our strong backlog – or our unique ability to solve some of the most complex intelligence and risk mitigation needs in the world. We have much to offer that the market needs, and we are in it for the long term. We continue to be confident in our future growth trajectory.

Now, I will turn it over to the operator for Q&A, where Josh, Julie and I will be joined by Jeff Dyer, President of Commercial, who's been leading our ProModel integration and growth plan.

Operator
And at this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press star, one, on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two, if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we poll for questions.

And our first question comes from the line of Louie DiPalma with William Blair. Please proceed with your question.

Louie DiPalma
Good afternoon, Reggie, Julie, Josh and Jeff.

Reggie Brothers
Hey, Louie.

Josh Kinley
Hey, Louie, how you doing?

Louie DiPalma
Great. Reggie, you mentioned how you won a contract for one of the largest healthcare, or hospital systems in the U.S. What is the addressable opportunity for additional wins for other healthcare systems in the United States? And do you have an already established healthcare offering that could be plug-and-play for other healthcare opportunities, or do you need to still invest more in order to realize the market potential for your healthcare data analytics products?

Reggie Brothers
Louie, thank you very much for the question. Yes, we do have an offering, and I'll let Jeff Dyer, who is the President of Commercial, answer that in greater detail.

Jeff Dyer
Thanks, Reggie, and thanks for the questions, Louie. I'll try to tackle each of those that you addressed. ProModel has a very established product called FutureFlow Rx. It's already had significant success that we've been able to leverage and accelerate in our go-to-market. The product offering has lots of potential use cases that we're accelerating through our advanced predictive analytics capabilities, leveraging our algorithms and machine learning that's rich in our federal side of the business.

There's over 6,000 hospitals in the United States alone that creates a logical addressable market for us to go invest as we build out our commercial strategy and our commercial sales force, to focus on selling the product that already has success with ProModel. But also bringing additional ideas that we believe are going to be significant in helping hospital customers be more efficient with respect to their general operations, their emergency room and operating room aspects of the business, as well as more visibility and transparency into their day-to-day operations.

So we're excited about the opportunity. We're still young in our integration of ProModel, but we're encouraged at the early success that we're seeing, and we're certainly encouraged by the feedback that we're getting from the customer base that's excited about the innovations that we're now accelerating in the roadmap.

Louie DiPalma
Thanks, Jeff. And for Julie, you referenced how you are investing in certain prototype contracts that have large upfront costs that are depressing your EBITDA margins right now. What is the long-term margin potential for BigBear as prototype contracts shift to production?

Julie Peffer
Yeah, thanks for the question, Louie, and great to meet you. Yeah, we are currently on some prototype contracts that we are making those investments in. We do have some follow-on kind of prototype projects that we're still working on for the rest of this year. But next year, we are expecting to get in 2023 some larger, much more profitable production contracts as it relates to this. So, you know, we don't necessarily see a very short-term impact from the standpoint of our margins getting significantly better in the short term, because we are continuing for the rest of the year to work on some of those prototype contracts.

But we are expecting that those are going to be fixed price contracts, and we think the margins are going to be, you know, definitely higher than our typical spend in those areas from a gross margin perspective. Much more typical of what you would normally see for our Analytics business in the range of 50% to 60% gross margin levels.

Louie DiPalma
Great. Are you able to share what types of verticals do these prototypes relate to?

Reggie Brothers
Yeah, sure, Louie. There's a couple of ones we can talk about. One has to do with cyber, for example. So, we have something we call SpaceCREST. And SpaceCREST is a collaboration with one of our partners, Redwire Space. And in this collaboration, we have developed a system that enables us to uncover some cyber vulnerabilities in satellite constellations. And as you know with the proliferation of commercial LEO satellites, this is an extremely needed capability. And this has led to several, including funded -- several opportunities including one funded at this point, so we're excited about that. So that's one area.

Another area has to do with spatial target identification and behavior forecasting, and it's one of our fortes. That's another one. And then we have one that has to do with our data as a service, one that has to do with computer vision as a service, and several others. So I think what we're doing is we're leveraging and cross-pollinating the skill sets we have in our cyber side as well as our analytics side, to create these prototypes.

And as you probably know, Louie, the government is starting to contract based on, you know, "show me," right? So it's no longer just based on past performance, but they're requiring you to show them something. And that requires us to make an upfront investment, and that's what these prototypes are all about. And these prototypes have allowed us, as I said, to gain entree into other customer bases, have allowed us to actually have a great win with U.S. Cyber Command.

And so we're excited about this opportunity, but as Julie had brought up, and you questioned, it does have challenges in the near term with respect to margin. So we see these as strategic investments, one that can open up additional opportunities for us to show off our advanced capabilities in cyber and in analytics, and cross pollinate both those areas.

Louie DiPalma
Great, that makes sense, Reggie. And also in your prepared remarks, you referenced how there actually were headwinds associated with the Ukraine war, at least you mentioned near-term headwinds. And ultimately, do you feel that the Ukraine war should be a long-term positive for BigBear, in terms of your pipeline opportunities?

Reggie Brothers
Yeah, so it's a great question. Thanks, Louie. So the issue with Ukraine, I think we saw early interest and continuing interest in our analytic products and services. I think one of the challenges we've run into, though, is that that investment has taken away unexpectedly from already funded programs, as well as from some of the lumpy -- and contributed to the lumpiness that Julie was talking about earlier.

So, in the near term, it has actually given us some headwinds. I think in the long term, because of the need for advanced intelligence, predictive capabilities, not only in Ukraine but also we have to think about the changing political climate, particularly in South Asia, right? You see what's going on, there's a tremendous need for that kind of intelligence. And so that's where we see longer-term value as well.

Now, that said, because of the longer government contracting delays which can take 12, 18, 24 months, these are not necessarily things that we are going to see immediate return on but are things that are strategically placed for us to take advantage of. So I think Ukraine, the tensions in South Asia, all contribute to strategic success for BigBear.ai.

Louie DiPalma
Sounds good. Thanks, Reggie, Julie, Josh and Jeff. That's it for me.

Reggie Brothers
Thanks, Louie.

Julie Peffer
Thank you.

Operator
Our next question comes from the line of Mike Latimore with Northland Capital Markets. Please proceed with your question.

Mike Latimore
Great, thanks, yeah. Good afternoon, everybody.

Reggie Brothers
Hey, Mike.

Julie Peffer
Hey, Mike.

Mike Latimore
Hi there. So the backlog change, you highlight the procurement services. Are those mostly in the Cyber & Engineering category? So we should see Analytics kind of increase as a percent here, or how should we think about that, I guess?

Julie Peffer
Yeah, it's a great callout. Yes, it would be mostly in the Cyber & Engineering segment.

Mike Latimore
Okay. And then I think at one point, you had given, you know, a backlog coverage of future revenue. So under the new backlog calculation, do you have a kind of rough percent of how much of the second-half revenue that covers?

Josh Kinley
How much of the second-half revenue is already in backlog.

Julie Peffer
Oh, how much of the second-half revenue is already in backlog; is that your question?

Mike Latimore
Yeah, yeah.

Julie Peffer
Yeah, I don't have that specific calculation, but I would suggest that most of it is already in backlog. We have some growth coming in that we anticipate, because we're starting to get signals that those are getting closer, but most if not a significant amount of it is already in backlog.

Mike Latimore
Okay, great. And then you talked about, you know, just OpEx improvements here. I guess what was the headcount at the end of the second quarter, and kind of where are you thinking that might end by year-end?

Julie Peffer
So our headcount, I think at the end of second quarter, was about 750 people. But in terms of really looking I would say, just to give you -- let's talk about headcount in general, in terms of SG&A costs. I would say a lot of the investments that we've been making in headcount, specifically around our growth strategy as well as around our corporate structure that we are creating because we're a public company. We were continuing to invest in that growth strategy and in investments in public company because we felt like we were in a pretty good place after the first quarter.

But when the softness kind of continued into the second quarter, that's when we felt like we need to step back and really take a harder look at all these SG&A expenses, and make sure that we're investing at the right pace and continuing to focus on the right things, in terms of the investment strategy. And maybe we take a step back and look at that in a broader perspective.

Mike Latimore
Yeah, okay. And then just on the federal vertical, I guess -- are the deals that are out there -- is your view they're still out there, in general? They're just -- they're a lower priority now, or have you seen kind of projects outright cancel here, I guess?

Julie Peffer
So we actually haven't seen any projects that have been canceled. What we've seen is just an elongation of the cycle. You know, I will tell you there's kind of general frustration across the board, both on the customer side, to be honest, as well as obviously on our side. You know, I think the contracting offices are just backlogged and they're getting re-prioritized to focus on opportunities to, you know, send money to the Ukraine war function.

So we're trying to make sure that we understand where they are in the cycle, but they've just been slower. So nobody's giving us any indication that things have changed. It's just taking longer to get them under contract.

Mike Latimore
Okay, okay. Alright, well, thanks a lot, good luck the rest of the year.

Julie Peffer
Thank you.

Reggie Brothers
Thanks, Mike.

Josh Kinley
Thanks, Mike.

Operator
And as a reminder, if anyone has any questions, you may press star, one, to join the question-and-answer queue. Our next question comes from the line of Michael Cho with Marathon Asset Management. Please proceed with your question.

Michael Cho
Hey, guys. Thanks for taking my call. There seems to be a $16.5 million increase year-over-year in SG&A and also a $5 million increase sequentially this quarter. What's kind of the right run rate according to the SG&A number going forward, especially in the light of your cost reduction plan? And my second question is, internally, do you have a reasonably expected reward timeline mapped out for those delayed rewards, or is it still kind of hard to predict? Thank you.

Julie Peffer
I'm sorry, I couldn't catch the second question. Could you say the second one again?

Michael Cho
Yeah, for those delayed rewards, do you have an expected timeline that is kind of -- that is reasonable? That's all I have.

Julie Peffer
We might take that one first.

Reggie Brothers
So we have one of the rewards we expect by, hopefully, next month. So, you know, we've got awards that have been delayed almost a year, but some of those we expect to be coming in the end of this coming quarter and beyond. So, yeah.

Julie Peffer
So, to go back to your first question, let's talk about the SG&A function. I mean, yes, you're right, we've seen significant increases in SG&A. And again, some of those -- big picture on SG&A is we've had increases year-over-year for sure related to our stock comp, which we didn't have in our business last year. We have a lot of public company expenses that we didn't have last year, so there is some significant growth in there that we understand.

But back to the point about run rate we are -- you know, I'm pretty new to the company. I've been here now about seven weeks and I'm doing a deep dive with the team right now to really dive into where have our investments been made, where do we need to focus on adding to streamline, how can we get efficiencies in our cost operating model.

So I guess I wish I had a clear answer for you as to how to factor in the run rate. I do expect in Q3 and Q4 it to be lower, but I haven't -- I can't give you a number on that exactly yet, but I do expect it to be lower than it has been in the past. We also had some one-time costs in our first half of the year as it related to transactions, our ProModel transaction, as well as some of the costs as it related to our legal costs for some of those activities as well.

Michael Cho
Thank you.

Operator
And we have reached the end of the question-and-answer session. Also, this concludes today's conference, and you may disconnect your lines at this time. We do thank you for your participation.