NASDAQ:TSSI Q2 2026 Earnings Call Transcript

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Operator | Conference Operator:

Greetings. Welcome to the TSS, Inc. Second Quarter 2026 Earnings Results Conference Call. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. If anyone, excuse me, I will now turn the conference over to your host, James Cabanera with Hayden IR. You may begin.

James Cabanera | Investor Relations, Hayden IR:

Thank you, Operator, and good afternoon, everyone. Joining me today on this call are the company's President and CEO, Darryl Dewan, and its CFO, Danny Chism. As we begin the call, I would like to remind everyone to take note of the cautionary language regarding forward-looking statements contained in the press release we issued today. That same language applies to comments and statements made on today's conference call. This call will contain time-sensitive information as well as forward-looking statements which are accurate only as of today, August 13, 2026. TSS expressly disclaims any obligation to update, amend, supplement, or otherwise review any information or forward-looking statements made on this conference call or the replay to reflect events or circumstances that may change or arise after the date indicated except as otherwise required by applicable law. For a list of the risks and uncertainties that may affect the company's future performance, please refer to the company's periodic filings with the SEC. In addition, We will be referring to non-GAAP financial measures. A reconciliation of the differences between these measures and the most directly comparable financial measures calculated in accordance with U.S. GAAP is included in today's press release. With that, Darryll, I'll turn the call over to you.

Darryl Dewan | President and CEO, TSS Inc.:

James, thank you, and good afternoon, everyone. Our second quarter results reflect how our company is growing its higher margin business lines while relying less on lower margin procurement. Demand for our systems integration capabilities remains strong and our revenue mix continues to shift in that direction. This shift improves the quality of our earnings. This is by design. The market for AI and high-performance computing infrastructure continues to expand dramatically. Customers are deploying increasingly sophisticated computer environments and are looking for partners who are flexible and capable and who can integrate, deploy, and manage that infrastructure efficiently. That's where TSS has built a strong position. That's where we continue to see healthy demand and volume growth ahead. Continued growth in our higher margin systems integration and facilities management business drove a favorable shift in our revenue mix during the second quarter. The shift towards our higher margin offerings is an underlying trend we continue to emphasize in the business, and it's one that gives us confidence in our long-term direction. Our higher margin systems integration business delivered strong growth during the quarter, increasing 46% year-over-year and representing 39% of total revenue, compared with just 22% of the total in the second quarter of last year. This is the important story behind the quarter. Our highest margin facilities management business also had an excellent quarter, growing 84%. Historically, procurement revenue has been our most variable generating at times high volume revenue on relatively few large customer orders. Customer purchasing patterns and a timing of infrastructure deployments can create significant swings from quarter to quarter. We saw that again this quarter with procurement revenue of $18.2 million compared to 33 a year ago. We are forecasting procurement revenues in the third quarter to return to our historical range of $30 million to $40 million, though that also can vary with last-minute order adjustments. with our higher margin systems integration and facilities management revenue streams representing a larger portion of our revenue and other income mix, profitability improved during the quarter with consolidated gross profit up 11% and adjusted EBITDA up 12% even as total revenue declined 20% due to the expected pullback and procurement. This is the kind of progression we'd expect to see as our business continues to shift towards higher margin offerings. We opened our newest integration facility here in Georgetown, Texas in mid-2025. Improving the efficiency of our integration processes and procedures is a primary focus for our operations team in order to deliver better value to our customers. We speak regularly about the constant and rapid evolution of data center and rack design driven by new chip releases, compute density, and each individual rack is increased in a short time driving significant changes in power and cooling. The rack integration process is similarly evolving along with rack densities. We plan the site for increased power needs and we work diligently with the local power utility authorities to have ample current power available plus capacity to grow. That said, there are numerous choke points in the integration process. NVIDIA currently drives the process with rollout of new chip families, each driving more compute power than the last. We have been integrating H100, 200, and the Blackwell families. Currently, we're seeing significant GB300 volume. We are in the midst of investing approximately $17 million to build the capacity to support NVIDIA's new Vera Rubin platform. We began this latest round of investment in Q2, and we should be completed mid-September. As we've discussed, such investments drive meaningful increases in recurring high margin revenue over the time period the assets are used to complete rack integrations. It's an important step because it strengthens our recurring revenue earnings base while expanding our relationship with our marquee customer. We are very encouraged by these accelerating trends. Customer engagement remains high The pipeline for higher margin systems integration continues to grow. The demand for our integration capabilities remains healthy and robust. Effective May 1st, we also began providing warehousing and logistics services to our largest customer at their request, fully utilizing our integration facility in Round Rock, Texas, which has been vacant. We expect the second half of 2026 to be stronger than the first half. And for the time being, We are maintaining our full-year adjusted EBIT outlook towards the upper end of the previously announced $20 to $22 million range. So in summary, the higher margin segments of our business continue to grow, recurring revenue continues to expand, and we're executing well for our customers in a market that continues to present significant long-term opportunity. We are excited about these results and the direction of our business. So with that, let me turn the call over to Danny to review the financial results.

Danny Chism | CFO, TSS Inc.:

Thanks, Darryl. Good afternoon, everyone. Before reviewing the financial performance, I want to highlight a change in the presentation and the results beginning in the second quarter. In May, we began using our previous integration facility in Round Rock, Texas to provide warehousing and logistics services to our largest customers, Darryl mentioned. We consider this an operating lease for GAAP purposes, and the lease operations are reported within our systems integration segment. Details of the accounting treatment are included in the 10-Q, which was filed just a few minutes ago. With that, let's go into the results. Total revenues for the second quarter were $35.1 million, compared with $44 million in the second quarter of 2025. We saw dramatic year-over-year growth in our higher margin business lines while reducing the dependence on lower margin procurement activities. Systems integration revenues increased 46% year-over-year, while facilities management revenue increased 84%. As we've mentioned on prior calls, procurement services remains an important part of our business. It carries the lowest margin among the three operating segments, but can produce wonderful incremental income and carries very little fixed costs in periods with lower volumes. Activity in this business is largely driven by the timing and scale of customer infrastructure purchases and deployment schedules. As a result, procurement revenue can fluctuate meaningfully from quarter to quarter depending on customer ordering patterns and the supply chain. Taking a closer look at each segment, Revenue from procurement services was $18.2 million, a decrease of 45% compared to the prior year quarter. As Darryl mentioned, orders received for Q3 already exceed procurement revenues in Q2, likely returning to more of our typical $30 to $40 million range per quarter. Revenue from our systems integration segment increased 46% from $9.5 million in the second quarter of 2025 to $13.9 million in Q2 of this year, reflecting continued customer demand for our integration capabilities, supporting AI and high performance computing infrastructure deployments. As we discussed previously, systems integration continues to be the primary driver of growth for TSS and represents a structurally higher margin business compared to procurement services. During the second quarter, that dynamic played out with systems integration representing 39% of total revenues compared to 22% in the prior year period. As this business continues to scale and leverage its relatively fixed cost base, we expect it to be an increasingly important contributor to gross profit growth and overall profitability. Revenue from facilities management increased 84% to $2.7 million, reflecting the continuation of ongoing maintenance agreements combined with a spike in discrete project work in the period similar to the increase we saw in Q1. Maintenance revenues in this segment decreased from $1 million in the prior year quarter to $746,000 in the current quarter as certain customers opted not to renew maintenance agreements on some of the older MDCs. That was more than offset by discrete project work increasing from just under a half million dollars this quarter last year to almost $2 million this quarter. Our facilities management team has done a great job helping end customers extend the useful lives of their MVCs by refreshing the infrastructure in them. The refresh of these units provides enhanced confidence in those customers' continued use of our preventative maintenance services. Moving down the income statement a bit, gross profit increased 11% year over year to $8 million and reflecting the shift to higher margin lines of business. Our blended gross margin improved 640 basis points from 16.4% this quarter last year to 22.8% in the current quarter. The procurement services gross margin improved to 11% in the second quarter compared to 7.7% this quarter last year. When viewed using non-GAAP gross value of all transactions, which we believe provides a more comparable view of procurement economics, The gross margin was 6% in the current quarter compared to 3.9% in the prior year period. Facilities management gross margin was 57.1% in the second quarter compared with 74.3% in the prior year period. As the margins in this line of business are typically near 50%, the current quarter results represent a return to more normal expectations, whereas the prior year quarter carried an unusually high margin tied to the expiration of certain maintenance agreements in which we incurred less costs in that period than what would normally be expected. As a result of the revenue growth in this segment, facilities management gross profit increased from $1.1 million this quarter last year to $1.6 million in the current quarter. Systems integration gross margin was 31.6% in the second quarter compared to 37.5% in the prior year quarter. The overall change was expected as a result of the increased depreciation charges we recognized in the current period related to our Georgetown, Texas facility, which was not fully operational during this time last year, so it didn't have comparable depreciation in that period. SG&A costs were $5.6 million in the second quarter, compared to $4.7 million in the prior year period. The increase was primarily driven by higher non-cash equity compensation Headcount, and related compensation costs to support the growing scale of the organization. We continue to maintain a disciplined approach to managing our cost structure while investing in the resources necessary to support long-term growth. With the growth in gross profit outpacing operating expense growth, we turned an 11% increase in gross profit into a 16% improvement in operating income from $1.4 million in the prior year quarter to $1.6 million in the current quarter. Interest on our bank loan was all capitalized this quarter last year as we were still wrapping up the build-out of our new Georgetown integration facility in that period, so the interest charges were being capitalized. That compares to $322,000 of interest expense in the current period as we continue to service the debt that we borrowed to finance that build-out. Interest expense continues to decrease each period as our debt amortizes down. As a result of higher cash on hand, Interest income increased to $565,000 in the second quarter compared to $175,000 this quarter last year. Our effective tax rate in the second quarter reflects the full impact of income taxes following the removal of the valuation allowance on our deferred tax assets in the fourth quarter of 2025. As we discussed previously, prior periods benefited from the partial release of the valuation allowance each period absorbing any federal taxes and a portion of our state taxes in that period. Following the release of that valuation allowance in Q4 2025, we're now recognizing income tax expense at the applicable statutory rates net of discrete tax benefits, which impacts year-over-year comparisons of net income and earnings per share. Income tax expense was $413,000 for the second quarter of 2026 compared with $69,000 in the prior year period. As a result, net income for the quarter was $1.4 million or 5 cents per diluted share compared to $1.5 million or 6 cents per diluted share in the second quarter of last year. Adjusted EBITDA improved 12% year over year to $4.5 million in the current quarter. Year to date, adjusted EBITDA improved 5% to $9.8 million.

Combined with our expectation that the second half of 2026 will be stronger than the first, as Darryl discussed, this gives us confidence in reaffirming our full year adjusted EBITDA outlook towards the upper end of our 20 to $22 million range. Taking a quick look at the balance sheet, we ended the quarter with $67.7 million in cash and cash equivalents and total debt of $16.1 million. With a strong balance sheet, with a strong cash balance and a leverage ratio below one, we believe we have the financial flexibility to continue investing in our systems integration capabilities, support customer growth, and execute on the opportunities we're seeing in the market. To summarize, our second quarter financial results demonstrate the continued progress we're making in shifting our business mix towards higher margin systems integration and facilities management revenues. While total revenues were impacted by lower procurement activity, our higher margin business continued to grow, driving improved gross profit and adjusted EBITDA. And we expect procurement revenues to revert to a more typical range in Q3. The investments we've made in our higher margin systems integration capabilities and the executive talent, combined with the expansion of our recurring revenue opportunities, are strengthening the quality of our earnings and positioning us for continued growth. With that, I'll turn the call back over to Darryl.

Darryl Dewan | President and CEO, TSS Inc.:

Great. Thank you, Daniel. Well said. We've said we're encouraged by the progress we're making, and we operate in an exciting business segment. The demand for AI and high-performance computing infrastructure remains strong, and we continue to see that translate into opportunities across our higher-margin systems integration and facilities management business. And as an example, we will install a new MDC Modular Data Center in September, October, and another in mid-2027. Interest in modular is increasing. The shift in our revenue mix is improving the quality of our earnings. We're maintaining a disciplined approach to execution and investing in the capabilities our customers need today while positioning TSS for continued long-term growth. Looking ahead, we remain confident in our 2026 outlook, Our customer engagement remains strong. Our pipelines continue to grow. We expect the second half of the year to be stronger than the first. Much of our excitement is factored into our annual outlook, and we're also planning to drive more integration business in the second half as the demand signal continues to accelerate. I would add from a business development standpoint, we have reorganized our sales team. and we are actively deploying and exploring how we can broaden our business in terms of customers, capabilities and capacity. Our core systems integration capability is a strong starting point. It provides us the visibility into what is happening in a data center as compute capacity and densities grow. Our team's number one priority is to provide great service to our existing customers with rapid time to value and we are concurrently making investments to assess capacity plan, and Capabilities Extension to enhance our offerings to customers. I expect to have more to report on that in the coming months and quarter. Before we open the call for questions, I'd like to thank our team members for their continued hard work and dedication, our customers for their trust in our partnership, and many of you, our shareholders, for your continued support. So thank you. Operator, we're ready to take questions.

Operator | Conference Operator:

Thank you. At this time, we will be conducting a question and answer session. If you would like to ask a question, please press star 1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star 2 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. Once again, please press star 1 if you have a question or comment. Our first question is from Matt Colitre with Needham. Please proceed.

Matt Colitre | Analyst, Needham:

Hey, guys. This is Matt Colitre over at Needham. Thank you for taking our questions. We want to make sure we're... We're clear here on the small sequential downtick in systems integration revenue. So is the idea here that you're seeing more demand for the GB200 racks and those take longer to test so they can't ship as fast? And then is that part of this $17 million investment in AI readiness and enhanced testing?

Danny Chism | CFO, TSS Inc.:

The second part of that question I'll take first, Matt. The $17 million is really investment in additional power infrastructure and cooling capability. There's a little more to it, but that's primarily it, specifically to be ready for NVIDIA's Vera Rubin configuration. So that requires more power, which then in turn requires more cooling. So that's really what that investment is directed towards, but that should directly drive incremental revenues in future periods. The second part of the question, Darryll, I don't know if you want to jump in on that. The sequential down take, we've been rolling right around that 14 to 14.2 million per quarter the last three quarters. This is in line with that same range. I think it's just barely down at 13.9. We are anticipating increases in that as we move forward. We'll start seeing the contribution from the investment in Vera Rubin readiness, as well as we'll start to see a little more contribution from the warehousing work that we just started doing that rolls into that as well.

Darryl Dewan | President and CEO, TSS Inc.:

Hey, Matt, there's a little bit more data there I'll share with you. It's a good question on quarter to quarter on the revenue. The mix of the RAC integration business We refer to it here internally as AI racks and mainstream, which is the high-performance computing capabilities, networking racks and compute racks. We had a downturn in Q2 over Q1 in the mainstream business segment. It was significant enough to have a little bit of impact, but I can tell you from an outlook going forward, that's not going to be an issue. The AI rack business that we all spent a lot of time talking about was up quarter over quarter.

Danny Chism | CFO, TSS Inc.:

I add a little bit more color, I guess, on the mainstream piece there, too. Some of what we're seeing, Matt, is a resurgence of demand specifically on network racks. As you deploy a lot of compute, you then also need the network racks to help with that. Those network racks typically go through our mainstream line, and that's where we're seeing a pretty good increase in demand coming through on those for Q3, Q4.

Matt Colitre | Analyst, Needham:

Gotcha. That's very helpful and good to know on the mix there. So what is left on the build-out for the power and cooling requirements for Vera Rubin? And how should we think about how much of a benefit this could be, I guess, both starting in 3Q and through the rest of the year?

Danny Chism | CFO, TSS Inc.:

Yeah, so you'll see on the statement of cash flows, you probably haven't had a chance to look through the full 10Q yet, but I think we've got something like $4.5 million, $4.7 million of capex. but really you need to look at that in combination with the incremental capex funded with AP that's down at a supplemental disclosure at the bottom of the cash flow statement. So we've completed seven to eight million as of quarter end of that build out. As Darryl mentioned, we plan on that being completed by September and we'll start putting that to use pretty quickly. So I anticipate that'll start driving incremental revenue some in Q3, primarily in Q4. And as far as specific timing, we've not put out the specific time of our agreement, but you can pretty well assume that would get recognized fairly radically over the term of remalty agreement for AI RAC integration.

Matt Colitre | Analyst, Needham:

Got it. That makes sense. Maybe just one more. We talked about how the AI rack business was up quarter to quarter and there's the nuance with the mainstream. What trends are you seeing in order volumes for Dell? Is there any way to think about how close you're getting to that weekly minimum commitment on the average week or anything like that?

Darryl Dewan | President and CEO, TSS Inc.:

Matt, that's a really good question. We really can't go into detail because it would be out of order for us to go talk about the pipeline in any more granular detail because it's outside of our house. But we refer to the outlook as very strong. And if you look at our key customers' public statements, They're pretty robust. They've increased their outlook for AI serventer in their fiscal year, 27. So we're doing everything we can to get as much of that growth as we possibly can. And that means that we've got to be really, really good at operating and that we've got to be really good at providing value. So we are full speed ahead to get as much of that as we can. Our outlook for the second half of the year is pretty strong compared to the first half. And going back to your minimum question, it is all of our desire to get over the minimum. And that works on a weekly basis, the way it's calculated. And I think we've gone over once or twice year to date. But the outlook is exciting. And We all want to get over the minimum. We all want to do as much as we can to take care of our key customer and what they're doing in the market.

Matt Colitre | Analyst, Needham:

That's great to hear. I appreciate the color, guys.

Operator | Conference Operator:

Once again, if you have a question or a comment, please press star 1 on your touchtone phone. The next question is from Alex Furman with Lucid Capital Markets. Please proceed.

Alex Furman | Analyst, Lucid Capital Markets:

Hey, guys. Thanks very much for taking my question here. You know, the systems integration revenue here sounds like there's a lot of potential for that to kind of accelerate from the $14 million per quarter sort of plateau, it looks like. We've been on for a couple quarters. Can you talk to longer term, bigger picture? I mean, what is the potential for growth in this business, assuming demand for AI servers remain strong. What's the gating factor to how fast you can grow and how much revenue you can generate in that business?

Darryl Dewan | President and CEO, TSS Inc.:

Alex, it's a good question. I think there's a couple of parts to the answer. One is we have got to be stellar in our operational efficiency. Number two is we need to make sure that we stay out in front of the technology curve, which is what we're doing right now. with some of the enhancements to handle the new technology coming down from the new platform. And we're preparing for the one after. And then you get into constraints around how much power do you have and how much space do you have. We happen to be in a very good labor market. We've got a good labor force. We think we can dial that up and down depending on the nature of the demand. I think we've got headroom that is significant over the minimum in this particular facility here. I've gone public and I said I think we've got 2 to 3x capability over the bare minimum in the contract. And in order for us to do that, we've got to be real tight operationally, and we've got to do and deliver when we say we're going to deliver.

Danny Chism | CFO, TSS Inc.:

And I'd add really the limiting factor is not so much been demand as much as it is supply chain. I think that's kind of universal. One quarter it may be memory, another quarter it may be a certain cable. There are so many parts that gives into these that as that aligns, that opens the floodgates for us to be able to do more. But I think that will continue to be a little bit of a gating item.

Darryl Dewan | President and CEO, TSS Inc.:

Okay, that's really hopeful. Another part Yeah, I mean, I probably should just shut up, right? But another part of the answer is, you know, we're talking about integration of racks. We're seeing an increase in conversation around the modular data center offering, getting closer to the edge, removing latency, given some of the environment around, you know, data center expansion and growth. It's a time-to-market value kind of proposition. and the way we are looking at taking advantage of that growth is by partnership and where appropriate, investing in skills that are needed to go promote and deliver a MDC solution like engineering skills and some potential sales skills. So we're looking at that as we speak.

Alex Furman | Analyst, Lucid Capital Markets:

Okay, that's really helpful. Thank you both very much. Thanks, Alex.

Operator | Conference Operator:

Okay, we have no further questions in the queue. I'd like to turn the floor back to Darryl Dewan for closing remarks.

Darryl Dewan | President and CEO, TSS Inc.:

Okay, thank you so much. I appreciate it. Everybody on the call, much appreciate your attention and time today. And thank you for your continued support. We are blessed and pleased with the shift to our higher margin systems integration business. We're excited about the continued growth in this segment. We talked a lot about, you know, where we've been, where we're going. We're optimistic about the business acceleration of the second half of the year, and our progress reviewing strategic growth options remains high on our list. So thank you, and see you again soon.

Operator | Conference Operator:

This concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.