Operator. Ladies and gentlemen, thank you for standing by, and welcome to the CTG First Quarter 2017 Financial Results conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. I would like to now turn the conference over to our host, Director of Investor Relations, Mr. Jim Culligan. Please go ahead.

Jim Culligan. Thank you, Filena, and good morning, everyone. With me today on the call are Bud Crumlish, CTG's President and CEO, and John Laubacker, Senior Vice President and CFO. Before we begin, I want to mention that statements during the course of this conference call that state the company's or management's intentions, hopes, beliefs, expectations, and predictions for the future are forward-looking statements. It's important to note that the company's actual results could differ materially from those projected. These forward-looking statements are based on information as of today, April 25, 2017. The company assumes no obligation to update these statements based on information from and after the date of this conference call. Additional information concerning factors that could cause actual results to differ from those in the forward-looking statements is contained in our earnings release, as well as in the company's SEC filings.

It's now my pleasure to turn the call over to Bud for his opening remarks.

Bud Crumlish. Thanks, Jim, and good morning, to all of you. I'll begin with an overview of our first quarter results and discuss how we are executing against our strategic plan, including continued steps to strengthen CTG's leadership and sales teams, then I'll provide updates on our four focus areas.

As announced in this morning's press release, first quarter revenue and earnings per share were both at the mid-point of our guidance with revenue at $77 million and EPS of $0.05. Overall, business performed well. The solutions business grew slightly over the prior quarter, offset by the expected modest decline in our staffing business related to the previous reduction in business at our largest client.

Highlighting the quarter was approximately 7% sequential year-over-year growth achieved in Europe, which has now delivered year-over-year growth for five consecutive quarters. Also significant, during the quarter we were notified that CTG has been selected as a core supplier for a new program at our largest staffing client. This new program reflects the continuing strength of our relationship with this long-time account.

As discussed last quarter, we introduced a detailed three-year strategic plan of financial goals. During the quarter, we took a number of steps to drive incremental shareholder value as part of executing towards these goals.

Let me start with enhancements to our sales organization where we are actively upgrading and continuously optimizing the team. We're diligently looking at what's working and who is effective, and decisively making changes in cases where it's not working. As a result, we've added multiple new sales individuals during the quarter as part of consistently up-leveling the team to improve our overall sales proficiency and performance. More specifically, as part of executing on this objective, we're placing increased emphasis on sales resources toward capturing incremental share and geographies where CTG has a strong existing market presence and client relationships, for example, Raleigh, North Carolina and Austin, Texas. The benefits include CTG's name recognition, increased opportunities for both internal and external client referrals, as well as close proximity to our infrastructure and the support resources.

Additionally, I've been personally spending time working directly alongside individual members of the sales teams and meeting face-to-face with clients. I think this is important for two reasons: first, it gives me the opportunity to build personal working relationships and further cultivate our sales team; and second, I believe the CEO attending meetings with clients demonstrates the truly distinctive level of CTG's total commitment to our clients.

Another area where we're making progress is the expansion of existing solutions across all lines of business. Since we announced and launched the ONE CTG program in early January, we consolidated several solutions into a new comprehensive solution we are calling Application Advantage. It's currently being rolled out across the company and is a portfolio of services tailored to meet our clients' needs. It's designed to maximize value, efficiency and cost effectiveness of application management. This is a first solution designed by our global solutions team and they've identified other solutions areas for future development in the coming quarters.

In addition to optimizing our sales resources, strengthening our leadership team continues to be a fundamental part of our strategy. Combined with our commitment to disciplined cost management, today we announced the consolidation of the executive roles of CFO and treasurer, which will now be a single position held by John Laubacker. You may remember that John was also the interim CFO at CTG a few years ago and has been with CTG for 21 years. He served as treasurer for the past ten years and possesses deep knowledge of our financials and operation. I look forward to working closely with him to achieve our financial goals in his now dual role as CFO (and Treasurer).

This appointment replaces Brendan Harrington, who resigned by mutual agreement. Brendan's dedication and significant contributions during his long tenure at CTG are deeply appreciated by the board and the entire executive team, and I want to personally thank and wish him the very best in his future aspirations.

This morning, we also announced the initiation of a search for the position of chief operating officer. As we execute on our three-year strategic plan, it's important that we focus our executive leadership line-up to help drive business development and operational efforts. We are ready in the process of evaluating multiple impressive candidates. Together with the board, I look forward to filling the position with a highly qualified individual who can drive both new and existing business relationships, as well as execute on enhancing the operation of our delivery and recruiting organizations.

Before speaking more specifically about our focus areas, here are a few observations about the market environment in general, many of which are based on first-hand conversations with our clients.

First, despite potential changes in the US's handling of visa permits, a number of companies continue to pursue international strategies, including infrastructure and support across multiple continents. Second, excluding one or two large clients, the number of requirements are increasing across most of our clients. Third, a significant number of employers are struggling to find the right technical people, and they're having to look beyond internal resources for a reliable IT services and solution provider, like CTG. And fourth, in general, we are seeing clients move at a faster pace than in recent memory. Many companies are looking to fill people with the needed expertise on a project basis, often as part of rolling out new initiatives or even launching new divisions.

What's important about these prevailing market trends is that they all represent favorable scenarios where CTG's ability to add value can be critically important to both existing and prospective clients.

I'll now shift to providing an update on our four focus areas and the steps we're taking to support our long-term growth objectives; these areas are staffing, Europe, healthcare and diversified industrials.

Beginning with our staffing business, as anticipated, revenue declined modestly on a sequential basis due to the reduction in revenue from our largest client. However, as previously mentioned, we were also awarded incremental new business by this large client for a contract that is expected to begin mid-year. Although it's too early to forecast the ultimate revenue contribution, I believe this win speaks for itself in terms of the ongoing relationship we have and how CTG is perceived by this client.

More generally, we continue to diligently execute on our key strategic objectives. This includes the expansion of our client base, especially in mid-market companies, as well as increased share of business at existing clients while maintaining a more deliberate focus on higher margin opportunities. We successfully added multiple new mid-market staffing clients and also expanded business with large existing clients during the first quarter. It's encouraging to see these incremental improvements in both areas.

Touching on our offshore delivery center in India, during the quarter recruiting activity was fairly stable and we also implemented a number of operational improvements. Specifically, we refined a team-level strategy and leadership structure, including bringing in a new executive to lead the operations at the center. In terms of potentially leveraging the center for technical work, we are actively engaged with multiple prospects that would be provided at least in-part by our team in India. I look forward to updating our progress on these opportunities in the coming quarters.

Turning to Europe, as highlighted earlier, our business grew both sequentially and year over year with revenue in the first quarter of over $19 million. This represents the highest quarterly revenue contribution from Europe in over two years, and a record percentage of total CTG revenue. Growth in our Europe business, which is concentrated in Belgium, Luxembourg and the UK, was led by a combination of recurring revenue from a stable client base and incremental business from new clients in the government, telecom and retail sectors.

CTG's leadership positioning in key market verticals and the long tenure of our seasoned sales team in Europe has consistently contributed to a number of new business wins in recent quarters. Also, in support of continued growth, we expect increasing contribution from previous significant wins, including those with the European ministries, a leading telecom operator, as well as now five signed contracts for EHR implementation with Belgian hospitals, which we discussed last quarter. In fact, since our fourth quarter call, the team estimated two additional proposals for EHR projects in Belgium.

In our healthcare business, revenue was roughly flat quarter over quarter, reflecting continued stabilization. Purchase decisions by hospitals are increasingly shifting from traditional consulting services to more specific solutions targeted at lowering costs. Recognizing the current market trends, our team's focus continues to be on enhancing CTG's healthcare offering and support our future growth. We are actively working to refine and demonstrate to prospective clients the cost effectiveness of our solutions in key areas, such as application management services, clinical helpdesk, optimization and performance improvement and implementation.

These solutions, along with pursuing increased healthcare staffing business, represent emerging opportunities for CTG in the healthcare market, many of which have attractive margins. Investing in the future growth of our healthcare business remains one of my top priorities.

Our diversified industrials business consists of a highly skilled group of solutions architects and software engineers with unique expertise across various industries. During the quarter, the team secured an annual contract for our new Application Advantage solution. We also recently signed a staffing agreement with a new client, which is a global engineering and construction firm. Given our diversified industrial group's growing pipeline at both new and existing clients, we are increasingly optimistic about the prospective growth of business throughout the remainder of 2017.

To conclude my remarks, since being appointed CEO in the middle of last year, one of the most frequent questions I have been asked is, what's going to change, what are you going to do different? My answer to that question is simple, and always has been—execution. In a relatively short period of time, we have successfully strengthened our leadership team from the Board on down, reduced costs and right-sized the organization, formalized a definitive three-year strategic plan and goals and adopted a strictly performance-based equity plan for senior executives.

We've also aggressively acted on a significantly expanded share repurchase program that was authorized by the Board in November. In fact, in just over five months, the company has used approximately $3.6 million of the $10 million authorized to repurchase 754,000 shares. These accomplishments help strengthen our foundation to support profitable growth and deliver greater value to our shareholders.

I'm confident our continued success on execution will drive incremental improvement that will ultimately enable us to achieve revenue and earnings growth that is consistent with our long-term goals.

With that, I'll now turn the call over to John for a discussion of our financial results.

John Laubacker. Thank you, Bud. Good morning, everyone, and we want to thank you again for joining our call today.

As we indicated in this morning's news release, revenue in the first quarter was $77 million compared with $77.5 million in the 2016 fourth quarter and $85.9 million in the year-ago quarter. Negative currency translation reduced revenue in the current quarter by approximately $800,000.

We had 64 billing days in the 2017 first quarter versus 65 days in the year-ago quarter. Staffing revenue decreased by approximately $830,000 from the fourth quarter or 1.5% and declined by $6 million, or 10%, year over year. The year-over-year decrease was primarily due to the reduction requirements from our largest client, which began in the 2016 fourth quarter and were completed in the 2017 first quarter.

Revenue from our solutions business increased sequentially from the fourth quarter by approximately $350,000, or 1.5%, and declined by $2.8 million, or 11%, year over year. Revenue from IBM in the 2017 first quarter was $20.3 million, or 26.4% of total revenue, compared with $23 million, or 29.7% of revenue, in the 2016 fourth quarter, and $25.9 million, or 30.2% of revenue, in the year-ago quarter.

Revenue from Lenovo was $9.4 million, or 12.2% of total revenue, compared with $8.3 million, or 9.6% of total revenue, in the year-ago quarter. Direct costs, as a percentage of revenue, were 81.5% in the first quarter compared with 80.8% in the fourth quarter of 2016 and 83.1% of revenue in the year-ago quarter. The year-over-year reduction in direct costs primarily reflects improved utilization and lower benefit costs.

SG&A expenses were 16.8% of revenue in the first quarter compared with 17% of revenue in the 2016 fourth quarter and 15.7% of revenue in the year-ago quarter. Despite SG&A expenses being higher year-over-year, as a percentage of total revenue, first quarter 2017 SG&A expense was $540,000 lower than in the year-ago quarter.

The effective tax rate for the first quarter was 41.2% compared with 28.8% in the 2016 fourth quarter and 1.6% in the year-ago quarter. Excluding the goodwill impairment charge, the non-GAAP income tax rate in the 2016 first quarter was 32.4%.

The higher effective tax rate in the 2017 first quarter reflects the required adoption of a new accounting standard, where the company recorded approximately $100,000 of additional tax expense related to employee stock-based compensation transactions that previously would have been recorded to shareholders' equity in the company's balance sheet.

Net income in the first quarter was $751,000, or $0.05 per diluted share, compared with net income of $1.1 million, or $0.07 per diluted share, in the fourth quarter of 2016, and a net loss of $20.9 million, or $1.34 per share, in the year-ago quarter. The net loss from the year-ago quarter included a charge of $21.5 million, or $1.38 per share, related to the goodwill impairment. 2017 first quarter results included equity-based compensation expense of approximately $0.01 per diluted share net of tax.

Our headcount at the end of the first quarter was approximately 3,300 compared with 3,400 at the end of the fourth quarter of 2016, and 3,500 at the end of the first quarter of 2016. Approximately 90% of our first quarter 2017 employees were billable resources, consistent with the 2016 fourth quarter.

Turning to our balance sheet, cash and cash equivalents at the end of the first quarter were $10.1 million with no outstanding debt. Day sales outstanding were 79 days in the 2017 first quarter compared with 81 days in the year-ago first quarter. The cash surrender value of life insurance policies was $31.1 million at the end of the 2017 first quarter.

We continue to list our two owned buildings for sale; the first building has a net book value of $1.2 million that remains on the market with an asking price of $3.3 million. The second office property has a book value of $1.7 million and is currently listed at a price of $3.2 million. Although today we have no formal offers in hand for either property, our ultimate goal continues to be the consolidation of our Buffalo-based workforce into a single building here in Buffalo.

CTG's tangible book value at the end of the first quarter was $5.02 per share. During the first quarter, the company repurchased 384,000 shares at an average price of $4.87 per share for a total cost of approximately $1.9 million. We repurchased 83,000 additional shares subsequent to quarter end, and today have approximately 6.4 million remaining under the existing repurchase authorization.

Turning to our guidance, we anticipate total revenue for the 2017 second quarter to be in the range from $77 million to $79 million. Our operating income is expected to be between 1.7% and 1.9%. We expect second quarter net income to be between $0.04 and $0.06 per diluted share. There are 64 billing days in the 2017 second quarter, the same as in the 2016 second quarter. The effective tax rate for the 2017 second quarter is expected to be approximately 40%.

For the full year 2017, we continue to anticipate revenue to be in the range of $312 million to $332 million. Operating margin for the full year is expected to be approximately 1.9%. Full-year net income is expected to be between $0.19 and $0.29 per diluted share. Finally, we expect the effective tax rate for the full year 2017 to be approximately 38%.

With that, we now open the call for questions. Operator, can you please manage our question-and-answer session?

Operator. Our first question comes from the line of Kevin Liu of B. Riley and Company.

Kevin Liu. You mentioned earlier that you won't know how much total revenue there is from this new win at IBM, but I was wondering if you could provide some additional details, namely whether you're still working within their systems and technology group, or if you've expanded beyond that, and also what sort of initial headcount requirements there might be as you guys set about launching this new program.

Bud Crumlish. It's something in addition to the STG organization, so this is something new for us. But in terms of headcount, we really don't have that information at this point in time. It's a staffing engagement and based on their needs, it's going to go up and down depending on what kind of engagements we have. But it's definitely something outside STG, so it's a new area for us.

Kevin Liu. Just as a follow on to that, would you expect the margin profile of the new work to be similar to what you've experienced historically, or is it at a different margin?

Bud Crumlish. I would say it's at historical margins, absolutely.

Kevin Liu. More generally, you guys seem to be on track with getting to your fiscal '17 targets, but obviously there's going to be a big step up required in revenue to get there in the back half of the year. So how much visibility do you have into that at this point, and how much more work is there to do in terms of new program wins in order to get you to that $80 million plus level in revenue.

Bud Crumlish. We're increasing our sales capacity and we're diligent about going after more and more RFPs and meeting with clients. Certainly, it is a step up in the back half of the year but we just put on some new people and we got new management in place to actually drive that business.

And, as I mentioned in my remarks, we're seeing our requirements increase, except for a couple of large clients. We're seeing the general economy pick up with a number of requirements. We're very focused on that and be responsive, and one of the key things we have to do is when we get the requirements ensure that we have the optimal recruiting organization to move forward and actually solidify those requirements and make those happen in the placements.

Kevin Liu. Last question, regarding Europe, you talked about some of the good growth you're seeing there as you move forward over the rest of this year and into next year. Any sense you can give us for what growth rate you could expect in that region? Do you expect it to be kind of above the company average for the foreseeable future? Are there any puts and takes that you expect?

Bud Crumlish. Yes, we're seeing that. We've been doing well in Europe, and I actually see Europe outperforming some of the other parts of the company. They've been strong; they've had a really good couple of years, specially this year. We've had some significant wins with the sales team. They're probably tracking in the 6% to 8% growth range.

Kevin Liu. That's all I had. Thanks so much.

Operator. The next question comes from the line of Vincent Colicchio with Barrington Research.

Vince Colicchio. I'm curious, are there any solutions that you've added or looked at in healthcare that you're excited about? Just hoping that you could share that with us.

Bud Crumlish. Actually, we started when the EHR implementations were at their peak, we were picking up, as you know, a lot of the legacy work, the legacy applications, so that the hospitals could take their existing IT staff and put those on the new implementations. That has a sunset date, because when they cut over, it goes away. But hospitals have been coming back to us and they really want us to take a look at managing their version upgrades and enhancements and patches and things like that. So it's more of your traditional application management; they're coming back to us for that.

And the other thing is the Clinical Helpdesk, that's another solution that we have. These EHR applications are very complex and a lot of the large hospitals—I am talking hospitals that are 1,000 beds or more—have implemented their own clinical support desk for the internal operating units of the hospital, like for physicians calling in, the nurses and others. But it's also a utilization problem, too, so that's one of our offerings that we have gone to the hospitals with.

These are level two and level three people, so they have a lot of expertise. By bringing in people that can handle more than one hospital at a time, say in the middle of the night, we're going to get a benefit there. And then a hospital can focus on providing care, we provide the clinical support desk for them so they can provide that care. That's another thing that's been taking off.

As well as going in and looking at their current systems to perform improvements on the system, as well to optimize the system. A lot of times they've been implemented but they still have a ways to go. They might be functional to 70%, 80% and we're going in with our group to do the analysis and actually upgrade the system, so they get more functionality out of it. The reason they want do that is because it's going to be more efficient and it's going to lower their overall costs.

Vince Colicchio. Regarding looking for a COO, what areas of the operations do you think you're falling short in terms of optimal efficiencies? Any details there will be appreciated.

Bud Crumlish. We are looking for someone primarily with business development and a sales organization and implementation background, as well as ensuring that we have the appropriate delivery and optimum recruiting mechanisms: the onshore-offshore recruiting; delivery, so that we can deliver the right value. A lot of what we do is time and material, but we do have some fixed price engagements. We want to make sure that we have the prudent business controls in place to do that. But business development, sales, and driving growth, are the primary requirements, and then secondary are delivery and recruiting.

Vince Colicchio. What are your current thoughts on tuck-in acquisitions to accelerate your improvement in some of the areas of the business?

Bud Crumlish. We are definitely looking, we're out there in the marketplace, and we're interested. It's got to be something that's strategic. It's got to be the right price and it's got to be the right deal. But we're always in the market and looking. We have been looking and have had some initial inquiries and some things.

Vince Colicchio. Thanks, Bud. I appreciate it.

Operator. Our last question comes from the line of Mark Jordan of Noble Capital Markets.

Mark Jordan. Good morning, gentlemen. A couple of related questions, I guess, about SG&A. You clearly have some cross currents there with consolidation and efficiency moves at headquarters and also the desire to expand and invest in incremental marketing capabilities. Could you talk a little bit about how you see the absolute level of SG&A moving forward, given those puts and takes? What are your goals and objectives relative to either further efficiencies and/or how do the investments impact the absolute level of investments? That'd be question one.

Question two: have you been able to quantify what your goals might be from a cost-saving standpoint when you're able to affect the consolidation of your facilities?

John Laubacker. Mark, let me tackle both of those. From an SG&A standpoint, overall, there's probably two parts to that answer; one, is short term and the other a long term goal. The long-term goal is to return ourselves back into that 15% range. It becomes challenging as you make investments in the business. And so what we are trying to do is be very diligent about making the appropriate changes in our costs that do not stunt any growth that we have. Any costs that we do manage to rearrange or move around, we're trying to put back into sales people or client partners and business development in any way to try and generate revenue. So the long-term goal there is 15%, but we're going to work our way toward that over time as we grow the business, and by making reinvestments and reinvesting some of those costs.

As far as consolidating the two offices that we have in Buffalo, each one is about $0.5 million in operating costs. So our goal is to get into one of the buildings by selling one of them and that should save us about $500,000 annually in operating costs.

Mark Jordan. Thank you very much.

Operator. At this time, there are no further questions.

Bud Crumlish. Thank you, operator. To close out the call, I'm encouraged by the traction that we've achieved today across the organization as evidenced by the expansion of new accounts, further penetration in existing accounts, as well as the increased activity on prospective new engagements. The entire company remains highly focused on execution against our strategic plan and financial objectives.

I want to thank you, everyone, our shareholders, for your continued support and belief in CTG. We appreciate you're joining today's call and look forward on reporting continued progress next quarter.