Operator. Ladies and gentlemen, thank you for standing by. Welcome to the CTG second quarter financial results conference call. At this time, all participants are in a listen-only mode. Later, we'll conduct a question-and-answer session and instructions will be given at that time. And as a reminder, this conference is being recorded. I'd now like to turn the conference over to our host, Mr. Jim Culligan, Director of Investor Relations. Please go ahead.

Jim Culligan. Thank you, Daniel, and good morning, everyone. With me on today's call are CTG's recently-appointed Chief Executive Officer, Bud Crumlish, and Brendan Harrington, Chief Financial Officer. Bud will begin the call with some opening remarks and an overview of the quarter with selective market commentary, and Brendan will follow with detail on our financial results. We will then open the call for questions. If you don't have a copy of the earnings results press release distributed early this morning, you can access it in the IR section of the company's website at www.ctg.com.

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 this date. 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. You can find these at our website or the SEC's website at www.sec.gov. Please review our forward-looking statements in conjunction with these precautionary factors.

It's now my pleasure to turn the call over to Bud to begin today's prepared remarks.

Bud Crumlish. Thanks, Jim. Good morning, everyone. I'm honored to be speaking to our investors, employees and other stakeholders today as CTG's Chief Executive Officer. I would first like to take this opportunity to thank the Board of Directors for entrusting me with the leadership of this great company and to my fellow CTG employees for the support they've shown since my recent appointment.

Since joining CTG in 1990, I've seen this company enjoy many good times and also weather a few tougher periods, like that which we're experiencing today. One thing I've learned is that it takes hard work and resourcefulness to get through the difficult periods. With the help of a strong management team and our proud and loyal employees, I'm confident, absolutely confident, that together we will not only overcome our current challenges, but also return CTG to growth.

During the next month or two, I, with the help of the management team, will carefully assess our current goals, objectives, and strategies. My sense is that our existing business plans are generally suitable to achieving our long-term growth objectives and that our future success will depend largely on execution.

Although I'll be in a better position to update you on any adjustments to our go-forward plans and strategy as part of our third quarter financial results conference call, I'd like to provide you with a brief overview of the results and progress made by our team during the second quarter. Then I'll turn the call over to Brendan to provide some additional financial information.

Revenue in the second quarter was $83.5 million, which was below our prior expectations, primarily as a result of weakness at multiple staffing clients. Second quarter earnings of $0.08 per share exceeded the guidance provided at the start of the second quarter. Excluding the benefit of foreign payroll tax credits recognized during the quarter, we still achieved the high end of our EPS guidance range.

Despite the headwinds to revenue, we continued to gain new business traction during the quarter by securing new clients in each of our four business units. This marked the second consecutive quarter in which we secured new clients in all units.

In addition to securing new client accounts, our team has also been focused on expanding the scope of services and the amount of business at existing accounts. During the second quarter, we successfully secured various new projects and contract extensions from these established client relationships. These expanded and renewed engagements complement the new client accounts that we've also secured, and demonstrate early results from investments made in our sales team.

Also notable during the quarter, we established a subsidiary in India to provide offshore recruiting and sourcing solutions to clients in the US as well as the UK. CTG's presence in India serves as a new strategic platform that we can leverage to offer alternative cost structures for various staffing solutions. Our India fulfillment center operates 24 hours a day with sourcers monitoring for new candidates around the clock. The sourcers then feed candidates to our recruiters in both India and the U.S. This 24-hour recruiting impacts the speed and quantity of qualified candidate submittals.

We're now actively hiring recruiters and sourcers in India. It's important to note that our plan is to continue to increase recruiter headcount in the United States as well, but not at the same pace as our operation in India.

Now, I'd like to provide a few selective highlights and general market commentary specific to our four business units: staffing, healthcare solution, diversified industrials and Europe.

In our staffing business, revenue in the quarter was generally in line with expectations excluding the weakness at a couple of our larger clients. Otherwise, activity in the quarter remained healthy as the job market continues to be strong for qualified candidates.

Over the last year and this past quarter, we've also taken actions to strengthen our staffing leadership, while simultaneously formalizing the process for identifying opportunities that could be transitioned into managed services and also convert existing solutions clients into potential staffing clients. Although this initiative is in its early stage, we believe that it will ultimately prove to be a meaningful contributor to our growth.

Turning now to healthcare solutions and life sciences, revenue decreased both sequentially and year-over-year as the broader healthcare market remained relatively soft, and we have continued to experience the expected trail off in revenue from our EMR implementations.

On a positive note, industry trends, including the ongoing consolidation across hospitals, providers and payers, continue to lead to an increased adoption of managed service provider programs in which we can leverage our staffing capabilities. In addition, application management services opportunities have been on the rise as organizations look for reliable solutions to manage their legacy applications while implementing new systems with their existing IT resources.

Also, the current absence of any major pending healthcare mandates, as well as the upcoming presidential election in the U.S., seem to be encouraging a wait-and-see approach on most large project opportunities. Nevertheless, we believe the longer-term growth outlook for healthcare and related IT services continues to be attractive. The healthcare market will continue to be a strong area of focus and an important element of CTG's long-term strategy.

We also want to mention that Al Hamilton, Vice President and General Manager, CTG Health Solutions and Life Sciences, resigned from CTG last Friday. We are currently evaluating the structure of this business unit and expect to complete that process relatively soon. The evaluation will include consideration to supplement our organization with additional capabilities and resources from the outside. However, the remaining health solutions sales and delivery team has deep expertise and experience and we believe in the near term there will be no disruption in this business unit.

Touching briefly on our diversified industrials group, which consists of offerings in energy, logistics, mining, telecommunications, and government, revenue was lower during the second quarter largely due to the ongoing volatility in the energy sector related to the low price of oil resulting in dramatic budget cuts across the industry. Our team has continued to be resilient despite this challenging market environment.

One of the most distinctive advantages that we have within this group is our talented consultants with deep industry expertise. During the quarter, our diversified industrials team secured a two-year contract extension with a high-profile international energy conglomerate. We're also making strong progress towards further diversifying outside of energy with multiple new opportunities to secure accounts in telecom, industrial logistics, as well as potential new state and local government business. We remain committed to further scaling our strong diversified industrials platform by penetrating adjacent end markets and geographies.

In Europe, CTG's diverse offerings span staffing, financial services, healthcare, life sciences, industrials, telecommunications, and government clients. Collectively, our European business unit performed well in the second quarter with revenue growing sequentially as well as year-over-year. This is particularly impressive given our concentrated presence in Belgium and Luxembourg, both of which had exposure to factors that negatively influenced the overall business environment in the region.

Despite the difficult business climate, our European team added new clients in the quarter, including the first EMR implementation with a partner hospital in a four-year contract with a prominent government health agency to provide IT development and maintenance solutions.

Looking forward, we have recently begun to see multiple indications that business activity is slowing, most notably in Belgium, where recently it's become unusually difficult to convert associates that historically have been relatively easy to place. Note, to date, we have not seen any immediate or meaningful impact from Brexit, but it's appropriate that we maintain a more cautious outlook for the region in the near-term.

Finally, we continue to believe that tuck-in acquisitions can complement an organic growth strategy by accelerating CTG's entry into new markets and geographies, while also rapidly adding to our existing capabilities and offerings. However, we are committed to a disciplined approach with our primary focus of generating organic growth through selected investments in our existing business, with our new fulfillment center in India being just one example.

I'll now turn the call over to Brendan to provide additional insight into the quarter. Brendan?

Brendan Harrington. Thanks, Bud. Good morning, everyone. I'll now supplement some of the financial information available in today's news release.

The positive currency translation increased second quarter revenue by approximately $300,000. There were 64 billing days in the 2016 second quarter versus 65 in the first quarter and compared with 63 days in the second quarter of 2015.

Staffing revenue was $58.9 million, a decrease of $1.2 million from the first quarter or 2% and a decline of $3.7 million or 5.9% year-over-year. Revenue from our solutions business totaled $24.6 million, reflecting a decline of $1.2 million or 4.5% sequentially and $7.5 million or 23.4% compared to the year-ago quarter.

Quarterly revenue from IBM was $25.1 million or 30.1% of total revenue compared with $25 million or 26.4% of revenue in the second quarter of 2015. Quarterly revenue from Lenovo was $8.3 million or 10% of revenue compared with $11.4 million or 12.1% of revenue in the year-ago quarter. Consistent with the prior expectations, our business with Lenovo appears to have stabilized over the past few quarters. However, the year-over-year comparison reflects the lower demand.

Direct costs, as a percentage of revenue, were 80.9% in the second quarter compared with 83% in the first quarter and 83.5% of revenue in the year-ago quarter. The company's direct costs, as a percentage of revenue, decreased in the 2016 second quarter and year-to-date periods as compared with the corresponding 2015 periods due to two charges taken in 2015 second quarter, which increased direct costs in 2015 by $2.1 million.

Additionally, the company's European operations recorded a payroll tax refund in the 2016 second quarter totaling approximately $700,000 which reduced direct costs in Q2 2016.

SG&A expenses were 16.8% of revenue in the second quarter compared with 15.7% of revenue in the first quarter and 15.3% in the second quarter of 2015. The increase reflects investments in sales, recruiting and delivery resources that are in support of generating long-term growth.

The effective tax rate for the second was 29.6% which benefited from certain US federal tax credits that had not been reinstated as of the end of last year's second quarter. Note that for modeling purposes, we believe that an effective tax rate range of approximately of 30% to 35% is appropriate for the second half of 2016.

Our headcount at the end of the second quarter was approximately 3,500, essentially unchanged compared with 3,500 at the end of the prior quarter and 3,800 at the end of the second quarter of 2015. The lower headcount compared with the year-ago second quarter primarily reflects the lower level of business activity with one of our larger staffing customers. Approximately 90% of our second quarter employees were billable resources.

Cash at the end of Q2 was $10.9 million and long-term debt was $4.6 million. Consistent with last quarter, the changes in other assets on the balance sheet compared to July 3, 2015 reflect the pay-down of $23 million in higher cost loans against the company-owned life insurance policies. The cash surrender value of life insurance policies at the end of the second quarter 2016 was $29.3 million.

Days sales outstanding were 81 days in the second quarter of 2016 compared with 61 days in the year-ago second quarter, primarily reflecting the cessation of an early payment discount with a significant customer in the third quarter of 2015 and the lengthening in contractual payment terms by a few larger customers.

CTG's corporate headquarters building, which has a net book value of $1.3 million, continues to be on the market at an asking price of $3.9 million.

And finally, the revised full-year revenue and EPS guidance provided in today's news release generally reflects weaker-than-previously expected revenue starting in the second quarter, primarily related to business with legacy accounts and then also adjusting for the above-guidance EPS that we reported for the second quarter. Given our respective third quarter and updated full-year guidance, our expectation is that the second half results will be weighted more toward the fourth quarter.

With that, we'd like to open the call questions. Daniel, can you please manage our Q&A session?

Operator. Our first question comes from the line of Vincent Colicchio from Barrington Research.

Vince Colicchio. Brendan, why did the payment cycles deteriorate with a number of large clients? What was behind that?

Brendan Harrington. We're just seeing, generally speaking, clients coming to us and looking to push out the payment terms; for example, going from 60-day payment terms to 65 days. And that seems to be a trend that's occurring and negatively impacting the DSO.

Vince Colicchio. So that's not going to be a transitory thing.

Brendan Harrington. I think it's more of a trend toward lengthening the payment cycles, especially by the larger customers. So, no, I don't think it's a transitional type of thing. We're working hard to try and maintain the length of the terms, but sometimes in contract negotiations that's something that clients are looking to push out a little bit.

Vince Colicchio. Bud, did I hear you correctly, did you mention that you did an EMR project in Europe? I'm just curious as to what your thoughts are on the EMR opportunity. I know that used to be something that the company was excited about, longer-term.

Bud Crumlish. Yes, absolutely. I did say that. It's the first one we're doing over there; we expect more in the future. And it's too early to say what the volume would be. There's still business in the United States in the EMR implementations—not as many, obviously, as it kind of peaked in 2012 and 2013--but certainly there is even work supplementing staff between some of the types of application we deal with—Epic, Cerner etc.—that are still out there. So it's still something that we're looking at closely.

Vince Colicchio. Some of the application outsourcing work you're doing on the healthcare side, isn't that kind of transitory or are other clients sort of moving towards more cloud or SaaS-based solutions? Won't they be phasing out some of those other projects you're working on?

Bud Crumlish. Well, we would do the transitional application management outsourcing for someone that's putting in a new system, but we know it's going to be sunset. That's a fixed period of time, maybe it's a couple of years. But we're still approaching other clients about taking over their existing applications as well because it's the same skill set. And, yes, you're absolutely right, cloud is a big deal and Software-as-a-Service as well. We may even see opportunities to help large hospital groups actually get into the cloud and help them transition and integrate what they have today to take it there. That's another area that we're looking at.

Operator. Our next question comes from Zach Cummins with B. Riley.

Zach Cummins. Good morning. I'm on the call for Kevin Liu today. It was positive news to see that the Lenovo revenue are beginning to stabilize. Are you confident that you can kind of sustain this going forward into the second half?

Bud Crumlish. They are certainly. Lenovo did a number of things in 2014 with the acquisitions they made for Motorola Mobility and also the x86 business from IBM. I think it was a transition over the past year, let's say almost a year-and-a-half, but I feel very good about what they're doing going forward. They're a very close client to us and I think that things will be positive in the future from there.

Zach Cummins. Where do you stand at this point on your healthcare sales team? I know over the past few quarters you've really been focused on ramping up that sales team. Do you have all the necessary parts in place or do you still need some additional changes going forward?

Bud Crumlish. We're going to evaluate all this. We hired a number of new people in December and in the first quarter, and it takes time. These are relationship sales. It takes time for people to get ramped up; they start small and it goes from there. You've got to prove yourself first, so to speak. So that all takes time. As far as we can tell, they're on track, but we're certainly going to evaluate that on a going-forward basis.

Zach Cummins. What are your expectations for a ramping period for a new salesman coming on the staff in the healthcare sector?

Bud Crumlish. In healthcare, it's really a consulting sale. It's something that typically takes 6, 9, sometimes 12 months. It all depends on the market and the complexity of the accounts. If it's a very large hospital group, it may be much more complex. So it's not something where you hire someone and in two months, they're where they should be. It takes time.

Operator. Our next question comes from the line of Bill Sutherland with Emerging Growth Equities.

Bill Sutherland. Good morning, everybody. While we're thinking about the sales expansion, based on the data of the sales group expansion that I have here in my notes, I see, at least through the first quarter, it had been doubled. Also, I think of the expansion in the industrial group. Are those folks kind of ramping as expected and has there been any churn that's notable?

Bud Crumlish. I would say, they're ramping as expected, Bill, and there really hasn't been any notable churn. Did they all make it? No. As you would expect, when you hire a group of people, not everybody is going to make it. But, certainly, the significant majority made it and they're going forward and we're starting to see some of those benefits now. We're trying to get our clients to move a little quicker. They never move as fast as we want but we're making progress.

Bill Sutherland. Do you think you'll be continuing to add to those groups or you just want to see how this initial expansion performs?

Bud Crumlish. I would say yes, we might be more specific to certain areas that we want to go after, and we want to get into some different capabilities, and that's really a part of this whole evaluation that we've got going on right now. There might be some things in the ERP space, for example, for healthcare.

There's been a lot of effort put on the electronic medical records, the clinical side, but there's the whole financial revenue cycle side to run a large hospital. And that's an area that we see as a potential opportunity, but again, it's in the evaluation stage.

Bill Sutherland. I think, Bud, you mentioned one potential approach going forward, taking staffing assignments into solutions. Maybe I didn't hear that correctly. I wonder if you could elaborate on that.

Bud Crumlish. Absolutely. No, you heard it correctly. We actually have a managing director with experience that we hired this past year from PwC. We help our clients develop their solutions, so they can, in turn, sell those solutions to their end clients. In a number of ways, it's turning from staffing to managed staffing and potentially could be a statement-of-work, and something that we could replicate with our other clients. So that's really what we're doing there.

And, conversely, with some of the healthcare accounts and diversified industrial accounts, we were focused on healthcare very heavily—on EMR implementations—but there's a lot of other IT work that are done in these organizations. With the capacity that we have, supplemented by our India operation even further, we can go after some of these large MSP--managed service provider--programs to try and take more of the IT budget for some of these large institutions.

Bill Sutherland. Including the big hospitals?

Bud Crumlish. Yes, exactly.

Bill Sutherland. Brendan, in your adjusted revenue guidance, what are you thinking as far as staffing and solutions growth?

Brendan Harrington. Staffing growth is approximately down about 5% for the full year and solutions growth in total is about negative 21%, with the vast majority of that being in the healthcare space. Total healthcare solutions is projected to be down about 35%, given especially the ramp down that we've been seeing in the EMR business.

Bill Sutherland. So it looks like it's kind of the point of the biggest headwind for that group.

Brendan Harrington. Yes. And we'd expect that as we get easier comps later in the year, especially in the fourth quarter, that that should be a more favorable trend. It will still be negative, but there won't be much of a headwind.

Operator. There are no further questions in queue. At this time, I'll turn it back over to you.

Bud Crumlish. Thank you, Daniel. CTG is a business with a 50-year legacy built in large part on a track record of providing our clients in North America and Europe with IT services and solutions to help them succeed. I sincerely believe that by leveraging this strong foundation and executing on our business plans, we will achieve our goals, create value for our shareholders, and maintain a challenging and rewarding work environment for our employees.

As largely anticipated, current macro and industry trends are proving to be a significant challenge for a number of our clients, resulting in lower revenue expectations for the third quarter and full year. However, we remain fully committed to working closely with all of our clients in providing the consistent unmatched reliability that sets CTG apart. We expect to further build on CTG's existing roster of new clients during the third quarter with the goal of exiting 2016 on strong footing and growing momentum.

We appreciate your time today and look forward to reporting on our continued progress in the upcoming quarters.
