Operator: Ladies and gentlemen, thank you for standing by and welcome to the CTG First Quarter 2018 Financial Results Conference Call. For the conference, all the participant lines are in a listen-only mode. There will be an opportunity for your questions; instructions will be given at that time. As a reminder, today's call is being recorded. I'll turn the conference now to Mr. Jim Culligan, Director of Investor Relations. Please go ahead, sir.

Jim Culligan: Thank you, John, and good morning, everyone. With me on today's call are Bud Crumlish, CTG's President and Chief Executive Officer; and John Laubacker, Senior Vice President and Chief Financial Officer. 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, Thursday, April 19, 2018. 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 made in the forward-looking statements is contained in our earnings release as well as the company's filings with the SEC.

Also, the company's press release and management's statements during the call will include discussions of certain adjusted non-GAAP measures and financial information. These financial measures, and a reconciliation of GAAP to non-GAAP results, are provided in both today's press release and the related Form 8-K. With that, I will turn the call over to Bud for his opening remarks.

Bud Crumlish Thanks, Jim, and good morning to everyone joining us on the call. As evidenced by our recent news events, 2018 has started out highly productive and exciting for CTG as a company as well as for our employees.

Beginning with a brief recap of our financial results, first quarter revenue exceeded the high end of our guidance range and grew almost 11% sequentially and 7% year-over-year to $82.8 million. The sequential and year-over-year improvement was primarily driven by continued strength in our existing business in Europe, including a partial quarter of revenue contribution from SOFT COMPANY.

First quarter operating margin was largely in line with our expectations and we continue to be focused on driving incremental operational improvements. Despite incurring additional costs associated with the acquisition, the integration of SOFT COMPANY as well as near-term expenses related to the accelerated onboarding of resources at our largest staffing client, which occurred in the last week of the quarter, we achieved earnings per share at the midpoint of our guidance.

In addition to our solid financial results, we demonstrated tangible progress as well as increased traction across all areas of our business. Increasing our new business activity and growing momentum is consistent with our plan. It reflects an initial return on the investments and strategic actions we've taken to strengthen CTG sales organization over the past 18 months. As we continue to execute against our strategic plan, we will realize further meaningful contribution from both recent and ongoing new business wins.

During the quarter, we also began the process of integrating SOFT COMPANY, our recent acquisition in France; the integration is going extremely well. The acquired business is also performing well and we remain confident in the value and future potential of this business as part of our effort to expand CTG's platform and presence in Europe.

Separately, and as part of our ongoing commitment to increase shareholder value, earlier this week, we completed the company's previously announced tender offer, resulting in the purchase of approximately 10% of CTG's outstanding shares. The Board also recently expanded our existing share repurchase authorization by an additional $10 million to further complement the tender offer and provide additional capacity for future potential open market purchases.

Now, I will provide specific updates on our staffing and solutions business as well as make a few comments on our strategic focus areas of Europe, healthcare, and diversified industrials.

Beginning with staffing, accounting for approximately 69% of total revenue, our results in this business have reflected certain crosscurrents consistent with the last few quarters. Continued momentum on our new business efforts has mostly been offset by ongoing weakness at a few of our largest staffing clients. We experienced similar dynamics in the first quarter, where consolidated revenue, excluding three of our largest staffing clients, grew an impressive 15.2% year-over-year.

As highlighted in this morning's press release, we were recently designated as a sole service provider for incremental new business at our largest client. Note this win is in addition to being selected as a preferred provider for a new division at this long-standing client that we highlighted last quarter.

Specific to the newest portion of the business awarded to CTG, we were asked by this client to deliver on an accelerated schedule to begin transitioning headcount from a previous provider. Our team successfully executed on the first phase of these transitions during the last week of the quarter. And in early April, we completed the second phase of this aggressive ramp of headcount and support of the client. More generally, within our staffing business, our strategy remains focused on key geographies and leveraging areas where CTG has strong existing market presence.

As part of our ongoing efforts to build, refine and optimize the sales organization, we announced the appointment of Susan Tidswell in February to lead our North America sales efforts and staffing. We saw meaningful improvement in our pipeline during the first quarter, including broader penetration at several recently secured new clients.

Importantly, our recent progress of both new and existing clients provides us with the increasing confidence that our combined ramp of new business wins will contribute to net growth in our staffing business beginning in the second quarter.

Turning to solutions, revenue for the first quarter grew 7.7% sequentially and 10.4% year-over-year to $25.3 million or approximately 31% of total revenue. This is the second consecutive quarter of growth in our solutions business and marks what we believe is the beginning of a new and sustainable trend, as we continue to convert our growing pipeline of engagements into revenue-generating business.

The key contributors to growth in the quarter included meaningful traction in our core IT service desk and application management solutions as well as our quality assurance and testing offerings, particularly in Europe. In support of achieving our longer-term financial targets, one of our key objective continues to be increasing our higher margin solutions business as a percent of total revenue. Notably, both CTG's organic business in Belgium and Luxembourg, and the business we acquired with SOFT COMPANY are comprised of a higher mix of solutions versus staffing. As such, we expect continued growth in Europe to be a primary contributor towards an increased mix of solutions business over time.

More broadly within solutions, we have continued to cultivate significant interest and receive positive feedback on our Application Advantage solution from both new and existing clients. In addition to actively pursuing an increasing number of Application Advantage engagements, our dedicated global solutions team is working to build out and finalize the capability for our next solutions offering. Consistent with our strategy, this new offering is specifically designed to meet the needs of clients by providing a tangible return on investment in the form of value efficiency and lower cost. We plan to formally launch a solution before midyear and I look to forward to providing more details about this offering next quarter.

Now, I'll turn to our three focus areas of Europe, healthcare, and diversified industrials. Our European business, once again, performed exceptionally well, demonstrating continued momentum in the quarter. Demand was particularly strong across the financial services sector as well as with our European ministries clients.

During the quarter, the team secured multiple incremental wins for our testing services and General Data Protection Regulation, or GDPR, offerings. We also signed our 10th EHR implementation in Europe. Our pipeline of new opportunities grew substantially, and our seasoned teams in Belgium and Luxembourg are actively submitting a number of proposal responses with large European institutions.

As part of our early integration efforts with SOFT COMPANY, we have completed an initial alignment of the respected sales team, which is a critical first step towards better understanding the collective needs of our clients. We continue to be excited by this highly synergistic combination of complementary capabilities and offerings. Together, we will benefit from increased scale as well as a single platform in Europe from which CTG can deliver a more expansive suite of solutions to our clients.

In healthcare, following our actions and significant efforts to reposition this area of our business over the last year, our refined strategy is beginning to demonstrate clear evidence of progress. Since yearend, our reinvigorated sales organization, led by Rob Barras, has secured new and expanded engagement for our application management, service desk solutions, and implementation offerings.

Highlighting these recent wins is an epic implementation with a notable US hospital system that is expected to begin in Q2 and meaningful application management engagements; one with a Tier 1 hospital, and another with a highly ranked university medical center. Both of these engagements are expected to begin ramping mid-year.

Value-based care is driving healthcare providers to do more with less, resulting in increased demand for managed services, especially in the areas of partial IT outsourcing. As the industry increasingly embraces value-based care, we are continuing to adapt our strategy in healthcare to directly align with this prevailing trend. During the first quarter, we launched a new sales campaign, targeted specifically at securing partial IT outsourcing engagements. Two of the three wins that I just mentioned, reflect the initial success of this campaign.

Our team is now working to roll out more direct solutions, focused around value-based care in the second half of the year. As our investments in sales and recruiting within Health Solutions continue to gain traction in the coming quarters, we will be positioned to further leverage our strong and well-established delivery capability, which CTG is known for across a larger number of healthcare clients.

Our diversified industrials business also performed well during the quarter as we finalized multiple contracts for work across the oil and gas industry as well as for our unique logistical solution required by a top-tier food and beverage client. Highlighting these new wins was a multimillion dollar, three-year managed service contract with one of the world's largest energy companies. Today, over half of our diversified industrials business is concentrated in Alaska, where the largely energy dependent economy has continued to struggle compared to the broader, more robust U.S. economy. As a result, we are increasingly focused on leveraging the unique skills and experience of our solutions architects and software engineers to expand into other geographies and adjacent industries with new, high-value consulting solutions.

In conclusion, as I have outlined, we had a strong start to 2018, including solid financial results, as well as evidence that our strategy is working and our growth initiatives are increasingly gaining traction. Since the beginning of the year, we successfully converted pipeline opportunities into new contracted work across all areas of our business.

In staffing, we were awarded incremental new business at our largest client. Within Health Solutions, we secured three significant wins in the U.S. and signed our 10th EHR implementation in Belgium. Diversified industrials finalized multiple new contracts. In Europe, we delivered another impressive quarter of organic growth and secured a number of new projects with large financial institutions. We also successfully completed the highly synergistic and immediately accretive acquisition of SOFT COMPANY, which we expect to further accelerate CTG's growth in the coming quarters.

Additionally, we've maintained and further demonstrated our commitment to maximizing shareholder value in 2018. In only the last two months, we proposed to declassify CTG's Board of Directors; also, the Board expanded our existing share repurchase authorization by $10 million. Earlier this week, we completed the previously announced tender offer, resulting in the company's purchase of 1.5 million shares, representing approximately 10% of CTG's outstanding shares.

Going forward, our focus will remain on executing our strategic plan and continuing to convert a robust pipeline into new contracted business. I also want to emphasize that driving operational efficiencies and improvement continues to be a fundamental part of our strategic plan. We've made a number of significant investments to strengthen our sales organization over the past few quarters in advance of the top line growth that we anticipate going forward. As these past investments increasingly contribute to revenue growth, they will produce incremental operating leverage and earnings in support of achieving our longer-term goals and financial targets.

I'll now turn the call over to John for a more detailed review of our first quarter financial results and guidance.

John Laubacker: Thank you, Bud. Good morning, everyone. We appreciate you joining us on today's conference call.

As we indicated in this morning's news release, consolidated revenue in the first quarter was $82.8 million compared with $74.6 million in the fourth quarter of 2017 and $77 million in the first quarter of 2017. First quarter 2018 revenue included $1.5 million from a change in accounting related to the new revenue recognition guidelines, which requires revenue we previously recorded on a net basis to now be recorded on a gross basis for global subcontractors. Revenue in the quarter also included a $3.8 million favorable currency translation. Billable days in the first quarter were 64 compared with 63 days in the fourth quarter of 2017, and 64 days in the year ago quarter.

Staffing revenue in the first quarter was $57.5 million, representing an increase of 12.4% sequentially and 6.3% year-over-year, primarily due to the mid-quarter addition of SOFT COMPANY. Solutions revenue was $25.3 million in the first quarter of 2018 and increased 7.7% sequentially and 10.4% compared to the year ago quarter. Excluding revenue from SOFT COMPANY and the three large staffing clients we have referenced in previous releases, total revenue in the first quarter increased 8.5% from the fourth quarter of 2017 and 15.2% from the first quarter of 2017.

Revenue from IBM in the first quarter was $18.9 million or 22.8% of total revenue compared with $18.5 million or 24.8% in the fourth quarter of 2017 and $20.3 million or 26.4% of total revenue in last year's first quarter. Revenue from Lenovo in the first quarter was $6.7 million or 8.1% of total revenue compared with $7 million or 9.4% in the fourth quarter of 2017 and $9.4 million or 12.2% of total revenue in the first quarter of 2017. Direct cost as a percentage of revenue were 80.8% in the first quarter compared with 79.7% in the fourth quarter of 2017 and 81.5% of revenue in the year ago quarter.

GAAP net income in the first quarter of 2018 was $422,000 or $0.03 per diluted share, which includes $0.03 per share in acquisition-related expenses. Non-GAAP net income, excluding this item, was $889,000 or $0.06 per diluted share compared with non-GAAP net income in the fourth quarter of 2017 of $865,000 or $0.06 per diluted share. GAAP net income in the first quarter of 2017 was $751,000 or $0.05 per diluted share.

Following the acquisition of SOFT COMPANY, which relies heavily on billable subcontractors, we've now revised how we define and calculate headcount in order to report all billable consultants, including both employees and subcontractors. Based upon this new approach, CTG's headcount at the end of the first quarter was approximately 3,650, which compared with 3,400 at the end of the fourth quarter of 2017, and 3,500 at the end of the first quarter of 2017. Approximately 90% of our first quarter of 2018 headcount was billable, which is consistent with previous levels.

Turning to our balance sheet, cash and short-term investments at the end of the first quarter were $11.2 million, and we had $9 million of outstanding long-term debt at quarter end. Capital expenditures in the 2018 first quarter were $800,000. In April 2018, subsequent to quarter end, the company borrowed $22.4 million against the cash surrender value of its life insurance policies, primarily to return capital to shareholders through the Dutch Auction tender offer, fund the acquisition of SOFT COMPANY, and for general working capital purposes.

Late last year, we consolidated our Buffalo-based employees into our corporate headquarters. In February, we closed on the $1.8 million sale of the vacated building. We recorded a gain of less than $100,000 from the sale in the first quarter of 2018. We estimate that our consolidation into a single building could save as much as $0.02 per diluted share in annual operating expenses going forward.

CTG's tangible book value at the end of the first quarter was $5.15 per share.

The company successfully closed its recent tender offer on Monday, April 16th. As a result, we expect to purchase an aggregate of approximately 1.5 million shares of CTG common stock at a price of $8.85 per share for an aggregate cost of approximately $13.5 million, excluding fees and expenses.

Subsequent to the completed tender offer, the company will have approximately $9 million remaining under our previously expanded repurchase authorization. With the successful closing the tender offer, the company will have now purchased 19% of total outstanding shares over the past 17 months.

Turning to our guidance, we anticipate total revenue in the second quarter of 2018 to be in the range from $87 million to $91 million. In addition, we expect second quarter GAAP net income to be in the range from $0.05 to $0.09 per diluted share and non-GAAP net income, excluding acquisition-related amortization, to be in the range from $0.06 to $0.10 per diluted share. There are 64 billing days in the second quarter of 2018, the same number as in the second quarter of 2017.

For the full year 2018, we anticipate revenue to be in the range from $343 million to $357 million, full year GAAP net income is expected to be from $0.25 to $0.37 per diluted share, and non-GAAP net income to be in the range from $0.30 to $0.42 per diluted share.

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

Operator: First in line is Vincent Colicchio with Barrington Research.

Bud Crumlish Good morning, Vince.

Vince Colicchio: Bud, your staffing side, you seem to have done a nice job adding new business in the U.S. and Europe. Curious, could you comment on the margin profile of that business versus historical levels?

Bud Crumlish I'd say it's fairly consistent with where it's been historically. Nothing substantially different at this point.

Vince Colicchio: Did I hear you correct, in terms of the EHR business in Europe, you've got a pipeline building there? And if so, how substantial is that?

Bud Crumlish Well, yes, we are definitely building a pipeline in Europe for the EMR business. And these are going to be multiyear engagements. The thing about it is, there's only so many resources over there, and the hospitals are moving at a certain pace. So, we expect to be doing this probably over the next three to five years.

And they're substantially smaller than the U.S. implementations, but we have a tremendous relationship with the university system that developed the software, and it's going really well. So, we're excited about adding another one to the queue.

Vince Colicchio: So, are things starting to move there in the broader market in Europe? Could you give us some color on that?

Bud Crumlish I would say yes, I think they are. For example, in Luxembourg there are financial institutions. And some of this has to do with—not right now—but Brexit. There's a lot of discussions and conversations going on about where some things are going to move, and we think that's going to be a plus, I think they're starting to get geared up for that. So, we see high demand and certainly, our challenge is finding qualified people and certainly retaining them because the market is really, really strong.

Vince Colicchio: An important driver for the SOFT acquisition was the cross-sell opportunities with the addition of the French footprint. Is it too early to tell? Are you hearing anything positive from the client base?

Bud Crumlish I think we're really early on in the whole thing. Taking the two sales teams—between what we traditionally had and the SOFT COMPANY sales team—they're really excited about the opportunities that they're bringing into their clients. We just closed on it 60 days ago, so they're getting acclimated. And they're trying to do account plans and things like that; what can we bring to the clients that we have today? But, they're very excited and I know we've gotten some comments from several clients that they really like these additional solutions offerings that we can bring now to them.

Operator: We have no further questions coming in.

Bud Crumlish Okay, John. Thank you very much. Before closing out today's call, I would like to acknowledge the entire CTG team and their contribution towards the progress that we've made over the past several quarters in support of growing the business and delivering increased shareholder value. Our first quarter results represent the initial return from the investments we made over this past year to strengthen our sales organization and new business activities, and we expect to continue converting our solid pipeline of opportunities into meaningful engagements and contracted business with both new and existing clients.

We've also strengthened our presence in Europe with the acquisition of SOFT COMPANY, further capitalizing on CTG's consistently strong performance in that region. And most recently, we continue to demonstrate our commitment to create shareholder value through the execution of a tender offer as well as the increased authorization of our share repurchase program.

With that, I would personally like to thank all of you for joining us on today's call and for your continued support of CTG. We look forward to reporting on our continued progress next quarter.
