Operator: Greetings and welcome to the CTG Fourth Quarter Fiscal Year 2022 Financial Results Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Craig Mychajluk, Investor Relations. Thank you, Craig. You may begin.

Craig Mychajluk: Yeah. Thank you, and good morning, everyone. We certainly appreciate your time today and your interest in CTG. Joining me are Filip Gydé, our President and CEO; and John Laubacker, our Chief Financial Officer. We released our fourth quarter and full year 2022 financial results this morning before the markets opened. You can access the release at our website at ctg.com. After Filip and John's formal discussion this morning, we will open the line for Q&A.

Just let me first remind you that we may make some forward-looking statements during the formal discussions as well as during the Q&A session. These statements apply to future events that are subject to risks and uncertainties, as well as other factors that could cause actual results to differ materially from what is stated on today's call. These risks and uncertainties and other factors are provided in the earnings release as well as with other documents filed with the Securities and Exchange Commission. These documents can be found on our website or at sec.gov.

During today's call, we'll also discuss non-GAAP financial measures, which we believe are useful in evaluating our performance. You should not consider this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliation of non-GAAP measures with comparable GAAP measures in the tables in today's release and SEC filing.

I'll now turn the call over to Filip to begin. Filip?

Filip Gydé: Thank you, Craig, and good morning, everyone. We appreciate you joining us today.

The fourth quarter capped off another excellent year for CTG as we accelerated our transformation into a digital solutions and services business. You can see the results of our efforts in our IT Solutions and Services segment results, including both North America and Europe, where our fourth quarter gross margin expanded 590 basis points to 31.8%, our highest level in recent years.

The performance within our North America segment, which includes the acquisition of Eleviant highlighted the potential of our transformation as we achieved gross margins of 43.9%. Our European segment also drove high margins from improved utilization and a greater mix of digital solutions.

As we complete the first phase of our transformation by the end of 2023 into an IT, digital solutions and services-based business, our strategy is based upon several key elements. First, we are focused on becoming a global provider of digital IT solutions by capitalizing on the compelling trends of digital transformation; leveraging the CTG brand, built on the foundation of reliability, speed of delivery and results; and delivering solutions primarily into the healthcare, finance, manufacturing, government and energy sectors, all of which are areas of strength for CTG.

As part of our digital solutions strategy, we are focusing on providing software engineering services which includes designing, testing, operating and enhancing digital products and platforms. We provided more than $100 million of these services in 2022,and the gross margin on these services was greater than 34% in the fourth quarter. We are excited by this success and look forward to increasing these results even more in the future.

The second element includes completing acquisitions that can become seeds for growth. We have three main criteria as we evaluate each opportunity. First, the company must be a well-established organization that is profitable. Second, the skill sets they have must accelerate our digital transformation strategy. And third, their solutions and people must be highly synergistic to our strategy. These criteria were met with the acquisition of Eleviant, which was previously a privately-owned digital transformation company.

As a reminder, this acquisition closes at the very end of the 2022 third quarter. And while small, from a revenue contribution standpoint, Eleviant has brought significant digital expertise in areas such as AI, machine learning and intelligent automation; while expanding our capabilities in cloud migration, mobile application development and other technologies, such as blockchain and best-in-class SaaS platforms.

To-date, the integration has gone exceptionally well and is exceeding our expectations. You can see the early benefits of their strong margin profile in our North America results during the quarter. Over time, we look forward to further driving sales synergies and delivering even greater value for our clients.

The third element of our strategy is to focus on lowering our delivery costs. Eleviant also brings this element to CTG as they increased our offshore delivery center capacity and flexibility with the addition of established teams in Chennai and Coimbatore, India.

Additionally, their expertise in artificial intelligence and robotic process automation will also allow us to automate a number of functions when we deliver services to our clients, further reducing our costs of delivery. Another important aspect to accelerate the execution of our overall strategy is our most important asset: our people.

We continue to add highly-experienced colleagues to our ranks. During the fourth quarter, we added the new global position of Chief People Officer, to ensure we have consistent policies and practices worldwide, and are continuously improving as an employer in the recruiting and retention of today's leading digital services and solutions staff. Our goal is to make CTG a destination of choice for highly talented digital transformation staff.

The disciplined execution of our strategy led to improved operating results. For the fourth quarter, our adjusted EBITDA margin was 6.2%, up 40 basis points over last year's period and 130 basis points higher over a two-year period. We continue to make incremental, steady progress toward our goals as we approach the end of the first phase of our transformation. These achievements would not have been possible without the hard work and dedication of our 3,000 colleagues across the globe, who respond to constantly evolving trends to create value for our clients every day.

Our clients turn to CTG as their trusted digital transformation partner and our outstanding employees are the very key to that success. We believe we are well-positioned as we head into 2023. Leveraging our strong foundation, breadth of key capabilities, culture of innovation and energized workforce provides confidence that we can continue to navigate underlying pressures and macro uncertainties to achieve our near-term goal of approximately 7% adjusted EBITDA margin by the end of 2023.

With that, let me turn it over to John to review our results in more detail. John?

John Laubacker: Thank you, Filip, and again, good morning, everyone. We thank you for joining us on today's call. Consolidated revenue in the fourth quarter was $77.9 million. The change in revenue year-over-year reflects last year's fourth quarter, benefiting from more than $25 million from a major health system engagement in North America, and a $9.3 million decrease related to the intentional disengagement from lower margin non-strategic business. Specifically in North America, we are generating solid leads in closing new customer engagements, and we benefited from the incremental contribution of Eleviant.

Europe, which has faced greater macroeconomic headwinds, including labor constraints, executed well to drive new solutions based business and generate a slight increase in revenue year-over-year on a constant currency basis. Full year consolidated revenue of $325.1 million was in line with our expectations and was also impacted by these two items: the significant engagement and the disengagement from low margin non-strategic projects. As we highlighted today, our margin profile improved during the quarter and year as we continued to optimize our revenue mix. Consolidated gross margin was 27.6%, up 530 basis points over last year's fourth quarter, and 630 basis points higher over a two-year period.

As Filip mentioned, the combined North America and Europe IT Solutions and Services segments delivered a fourth quarter gross margin of 31.8%, further highlighting our continued transformation to a digital IT solutions company. Our focus going forward will be on the combined results of our IT Solutions and Services segments, as that is the core of our strategic focus and as we expect the non-strategic segment to have less of an impact on our overall results going forward as it continues to decrease in size.

For the full year 2022, which reflected similar results as fourth quarter, gross margin on a consolidated basis was up 260 basis points to 24.6% as each segment drove gross margin expansion. This increase was more than a 10% increase year-over-year. SG&A expense for the quarter and full year saw declines on an absolute dollar basis, but as a percentage of revenue were both up largely due to the continued investments in business development resources and the loss of operating leverage from lower revenue.

For the fourth quarter, GAAP operating income was $2.5 million, with a margin of 3.1%. When excluding $696,000 of acquisition-related expenses and $838,000 of severance, the non-GAAP operating income was $4 million or 5.1% of revenue, up 30 basis points. The full year had comparable results with the GAAP operating margin expanding 20 basis points to 3.4% and the non-GAAP operating margin expanding 70 basis points to 4.3%.

We recorded net income of $1.2 million or $0.08 per diluted share in the quarter, compared with $0.58 in the prior year. Non-GAAP diluted EPS, again excluding the acquisition related costs and severance, was $0.14 compared with $0.25 in the year ago quarter. Of note, the effective tax rate was elevated in the quarter at 37.5% due to a number of non-deductible items. We expect in the long term, our tax rate to be between 30% and 35%.

For the full year 2022, net income was $6.6 million or $0.44 per diluted share and on a non-GAAP basis was $0.56 per diluted share, slightly exceeding the midpoint of our expectations. Lastly, our net income margin was 1.6% in the quarter and 2.0% for the full year. Our adjusted EBITDA margin improved to 6.2% in the fourth quarter, which was up 40 basis points from the year ago quarter and was 5.3% for the full year, up 70 basis points from the prior year. Approximately 86% of our total head count in the fourth quarter was billable, paired with 90% in the prior year period.

We continue to maintain a strong and flexible balance sheet that can be leveraged to accelerate our pace of growth in the future. We generated cash from operations during the year of $11.9 million. Cash and cash equivalents were $25.1 million at year end, compared with $35.6 million at year end 2021, reflecting the cash used to acquire Eleviant. Also at the end of the year, we had no outstanding balance on our revolving line of credit facility or any other long-term debt.

We provided our initial top and bottom line guidance for fiscal 2023. Our revenue range of $300 million to $350 million includes a reduction of $35 million to $40 million from the prior year as a result of the intentional disengagement from the lowest margin business in our non-strategic technology services segment. Slightly offset by a full year revenue from our acquisition of Eleviant, which only had one quarter of revenue in 2022 with the acquisition was completed at the end of the third quarter, and high-single digit growth for the rest of the business.

We also provided guidance for IT Solutions and Services revenue ranging from $245 million to $295 million, or about 83% of our total revenue at the midpoint. We expect 2023 GAAP diluted earnings per share to range from $0.34 to $0.46 and non-GAAP diluted earnings per share to range from $0.56 to $0.68.

As also noted in today's earnings release, we are kicking off an ERP system implementation to enhance our core operating systems in order to create additional efficiencies, capabilities and flexibility. The total project cost is estimated at $8 million to $10 million and will be largely spread out over two-year period with a completion date target around the end of 2024. A significant portion of these costs will be expensed over the course of the project. Our GAAP EPS estimates for 2023 take this project into consideration, though we plan to add back those costs as part of our non-GAAP EPS disclosures.

The difference in our GAAP and non-GAAP EPS will be larger in 2023 as compared with prior years as we account for the amortization of the intangible assets created by the acquisition of Eleviant and this ERP implementation. Ultimately, we continue to expect our strategy to drive improved margins and are on track to reach our adjusted EBITDA margin goal of a run rate of approximately 7% by the end of 2023.

This completes our prepared remarks. Paul, could you please open the call for questions?

Question And Answer

Operator: [Operator instructions] Our first question is from Kevin Liu with K. Liu & Company.

Kevin Liu: Hey. Good morning, guys, and very nice finish to 2022 here. First question I have is – was just, what are you seeing in general in terms of the pipeline and conversion rates? It seems like the commentary there in terms of the business activity was more positive coming out of the year. So – and obviously your guidance on IT solutions kind of implies mid-teens growth at the midpoint even with some of that coming from the acquisition of course. But in general, it seems like a very positive outlook when a lot of other folks out there a little bit more conservative in terms of some of the growth aspirations for this year. So what have you guys seen in terms of overall improvements in the pipeline conversion rates, that sort of stuff and what's kind of built into your guidance for this year?

Filip Gydé: All right. Well, Kevin, we are extremely encouraged I must say with the progress we are making on executing our strategy despite those macroeconomic headwinds. And we acknowledge that they are there, but we are looking at our pipeline and we see a large number of opportunities. We see win rates that are solid, renewables expansions continue at a high pace. We actually even see throughput on the pipeline improving where it, as you remember, had lagged for some time during the pandemic.

And of course, with Eleviant, we also expect to drive sales synergies and deliver even greater value for our clients, the things that Eleviant is adding to our mix, trying to make our puzzle more complete or almost complete. So I think we have made a really good decision in the acquisition of Eleviant, and that is the expectations there is that we'll see that during the remainder of the year in an increasing pipeline. John, would you like to comment on the guidance?

John Laubacker: Yes. Thanks, Filip. And, hi, Kevin. How are you? The guidance itself, we really feel good about the guidance. And just to interpret right at the end there, you had said – you had talked about mid-teens increase in revenue, including the acquisition. And so when we think about Eleviant and the $10 million run rate and sort of a normal natural increase or high level increase actually is the expectation for that business. The rest of the business would increase, we think, at high-single digits, around 8% at the midpoint of the guidance. And so from our perspective, feeling really good that that's about in most markets, that's about 2x what the market is growing at this time.

Kevin Liu: Great. Appreciate that. And just with respect to Europe, obviously, nice sequential rebound there. It seemed like utilization was better. Can you just talk about the overall environment? Have some of the labor issues you cited in the past few quarters abated here? Have win rates started to improve on new projects? Just wondering, how positive you are on continuing that sequential improvement as we move into 2023?

Filip Gydé: Yes, we had an excellent fourth quarter in Europe. Our team did fantastic job in driving the revenue and the profits in the quarter. There are some headwinds going into 2023. The government requires automatic indexation to compensation for our employees in Belgium and Luxembourg, and that happens automatically in Belgium on January 1st. Luxembourg is February, April and maybe even a third time in 2023, and also for the employees of our clients. So it means that it's a sudden increase of our costs on January 1st in Belgium, but it also means that our clients have the same increase of cost and obviously have less spending possibilities. We are able to pass part of these costs on to the clients through higher bill rates at the beginning of the year, but it will take – it probably will take the first half of the year to pass along most of those costs.

The level of labor constraints is still there. And it – the resources that are needed to help client opportunities are scarce, are difficult to recruit. We are looking, not only looking, but also hiring people fresh from school and training them through our CTG Academy to make them – to bring them to the level that they can participate in client projects. And we also, of course, count on our global delivery centers, where we now have more capacity and flexibility to add to this or to help solve this problem of labor constraints. But all in all, an excellent fourth quarter, and we're hoping we're going to continue at the same pace.

Kevin Liu: It is great to hear. And then just lastly for me, I don't know if you can quantify the impact Eleviant had on your North America IT Solutions gross margin in this quarter and maybe just speak qualitatively to how much of the improvement there has come just from the acquisition versus also just the improving mix of solutions work on the organic side? And as we look forward to 2023, is it your expectation that you can kind of sustain North America margins north of 40% here?

Filip Gydé: John, would you like to take that question?

John Laubacker: Sure. Thanks, Filip. Great question, Kevin. Eleviant was outstanding in the fourth quarter. We have not specifically quantified the gross margin contribution, but we have said and indicated that their gross is over 50%. It has really been a fantastic addition to the CTG portfolio of companies, and we just feel great about understanding their business and expanding it as we cross-sell with the CTG's clients. Having said that, we had a really, really good quarter from a gross margin perspective throughout our North American organization as well. Really fantastic job by the teams executing as well as they could to drive margins to a very high level.

From that perspective, I would not expect us to continue at almost a 44% gross margin in North America, but certainly you mentioned 40%. I would have a very high expectation that we would be – we have a high expectation that we would be in the high-30s or pushing 40% pretty consistently as a gross margin in North America. So I think Q4 was a little higher than normal, but we have expectations that it will be high-30s to 40-ish going forward.

Kevin Liu: All right. Well, that all sounds good. Congrats again on the results for the quarter and good luck here in 2023.

John Laubacker: Thanks, Kevin.

Filip Gydé: Thanks, Kevin.

Operator: Our next question is from Marc Riddick with Sidoti.

Marc Riddick: Good morning. So, I was wondering if you could talk a little bit about the ERP upcoming and maybe what we should be thinking about from a timing perspective and sort of maybe the geographic flow perspective, maybe we just sort of be thinking about that what we're going to be seeing this year?

Filip Gydé: John, would you like to comment on that?

John Laubacker: Sure. Hey, Marc. The ERP implementation is going to be a global project. So, this is a worldwide consolidated all parts of CTG improvement in all of our core systems globally. We've done an amazing amount of planning up until this point in time. So much of the planning for the go forward in 2023 has been done in late 2021 and all throughout 2022. And so, we're ready to hit the ground this – running here in 2023. We have started the project. And so all of the planning phase up to this point is pretty much out of the way and you always do some planning. You should get into it as you revise your course and your method. But most of that is behind us.

We are starting to implement now. We do think that as a global company it'll take two years. We'll take all the 2023 and 2024 to sort of get to end game on each individual piece of the implementation itself. So think ERPs and core accounting systems, think recruiting, think resource management and development along with some ancillary type systems. And then think globally around the North American organization and European organization where we have got operations in a number of different countries as well. So I think it will be very consistent throughout 2023 and 2024, but I do think it's a full two-year project at this point in time.

Marc Riddick: Okay. Great. That is very helpful. And then I was wondering if you could talk a little bit about the – and I really appreciate the – in the press release, the – sort of the inclusion of the sort of what you're seeing in some of those industry verticals. Maybe you can take a little bit of time as well as some of the thoughts that you have as to how you're looking at those industry verticals and maybe what you're seeing now and then sort of how that played into the setting of guidance?

Filip Gydé: Sure, Marc. Well, let me start first by saying our focus on the digital transformation services and more specifically on software engineering is not a focus on one or two industries, it is focused on a number of verticals. And like we said, healthcare, finance, manufacturing, government, energy. We know, for instance, that healthcare sector is under pressure. There's not a lot of financial room for especially the providers. The health insurers are in a better shape. But we also see that as an opportunity because healthcare providers have for a long time being very reluctant to look at offshore delivery centers. And we think with this situation, it will probably change their attitudes and we will be able to capitalize on what we're doing with Eleviant also in that sector, which, as you know, is very important to us.

The financial sector is focusing on digital transformation, even more on the insurance side than on the banking side. But we see good opportunities there, too. Government in Europe is solid. We have a presence, both in national governments and then in the European institutions. We see solid contracts there; we see good opportunities and our energy sector is growing. We are investing also more in sales and in solution architects that are focused on our energy sector. And we see that our pipeline in that area is growing. So all in all, I'd say a positive view on how we see our industry.

Marc Riddick: Okay, great. And then I wanted to circle back, I want to make sure that I heard correctly and interpret this properly. I think, John, you had a commentary as far as the tax rate being in the, I think you said 30% to 35%. If I misheard that, please correct me. And then, I was wondering if you could talk a little bit about, is that a function of sort of – kind of where we are now with geographic footprint and the like?

John Laubacker: Yes. Marc, I'm not sure the first part of the question is specifically.

Marc Riddick: I just want to make sure I heard the tax rate commentary.

John Laubacker: Okay. Yes. Okay. Tax rate, 30% to 35%, it has been a little bit higher the last two quarters as there's been a number of non-deductible items that we've worked our way through. But don't expect that to happen in the future. I really do think it will be between 30% and 35% going forward from that perspective. Relative to the globally and the pieces of the business, when you look at it overall, we expect good growth from our European organization this year. They had a really, really fantastic fourth quarter, great performance from the teams, great focus, expect good things from them throughout 2023.

We do expect our North American IT Solutions and Services segment to grow as well, well during the year, and we've got Eleviant working closely with that team. And so, we've included Eleviant, the acquisition we did included in that bucket, so we think we will grow well. But from a geographical standpoint, we had talked about well from a segment standpoint, the non-strategic, we'll have a – we think a very significant decrease in throughout 2023, $35 million to $40 million is what we're estimating as part of our guidance. Most of that is in North America.

So I really expect at the end of the year that Europe will be over. It will kind of flip from just under 50% to over 50% of the business going forward. And then, it will be a friendly competition within the organization to see who can grow the fastest to maintain that lead in total revenue.

Marc Riddick: Excellent. And then the last one for me, a little bit of housekeeping, I suppose. Where do we finish on CapEx this year and what are we expecting for 2023?

John Laubacker: Yes. Let me just get that for you, CapEx was – here it is. Total CapEx was only $1.5 million for the year, which included additions to the capitalized software. I would expect it to be a little bit higher in 2023 as we grow the business. We do have some real opportunities from the great products that Eleviant brings to the table to capitalize on costs there. So I think it will be a little bit higher. But they don't expect it to be more than say $2 million, $2.5 million in 2023.

Marc Riddick: Excellent. Thank you very much.

John Laubacker: Thanks, Marc.

Filip Gydé: Thanks, Marc.

Operator: Thank you. There are no further questions at this time. I'd like to turn the floor back over to management for any closing comments.

Filip Gydé: Thanks, Paul. As demonstrated this past year, we are making excellent progress executing our digital solutions transformation strategy, and we expect that to continue in 2023 as we complete the first phase of our transformation. We look forward to reporting on our success throughout the coming year and sharing our improved operating results expectations for our second phase in the near term.

Thank you for participating in our teleconference today. And as always, please feel free to reach out to us at any time. We look forward to talking with all of you again after our first quarter 2023 results. We hope you have a great day. Paul, you may now disconnect the call.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.

Note: This transcript has been edited slightly to make it more readable. It is not intended to be a verbatim recreation of the Computer Task Group, Inc. (CTG) financial results teleconference and webcast that occurred on the date noted. Please refer to the webcast version of the call, which is available on the Company's website (www.ctg.com), as well as to information available on the SEC's website (www.sec.gov) before making an investment decision. Please also refer to the opening remarks of this call for CTG's announcement concerning forward-looking statements that were made during this call.