Operator. Ladies and gentlemen, thank you for standing by, and welcome to the CTG Second Quarter 2017 Financial Results Call. At this time, all lines are in a listen-only mode. Later, we will conduct a question-and-answer session. Instructions will be given at that time. As a reminder, today's conference is being recorded. I would like to now turn the conference over to the Director of Investor Relations, Jim Culligan. Please go ahead.

Jim Culligan. Thank you, Ryan, and good morning, everyone. With me today 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, Tuesday, July 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 made in 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 on the call. I'll start with a brief overview of our financial results for the quarter. As announced in today's press release, second quarter revenue was $75.5 million, which is lower than the midpoint of our guidance due to softer demand in a few of our larger staffing clients. This softness was further magnified by the delayed issuance of purchase orders at one client in particular. A portion of these purchase orders have ultimately been released. Others remain on hold, but we expect them to be issued in the next coming months.

In regards to the new business efforts, our continuous emphasis on expansion and diversification of CTG's client base resulted in a number of new client wins for the quarter as well as a sequential increase in new revenue. The majority of these accounts are still in the early stage of ramping, and the new business offset some of the quarterly weakness we saw at our larger accounts. Despite lower revenue, our diligent cost management and further improvement in efficiencies throughout the organization enabled us to deliver earnings of $0.06, excluding severance charges, which was at the high end of our guidance.

This achievement demonstrates our continued commitment to preserve earnings while simultaneously remaining focused on driving new business and client expansion. The actions we've taken this year lay the foundation to accelerate growth in the future and we see that our strategy is working.

Our sales pipeline is significantly stronger, and we've been increasing the size and caliber of our sales organization. We're building an accountable sales culture, and we continue to make judicious investments in our leadership team. As part of these investments, we made significant progress in our search for a newly created senior executive sales leadership position. The decision to create this new role better aligns with our ongoing emphasis on driving new business across the enterprise and replaces a search for a COO position that we mentioned last quarter. We expect to fill this sales leadership position and formally announce an appointment by the end of August.

In terms of our stock repurchase, we repurchased an additional 257,000 shares under our authorized share buyback program during the quarter, amounting to $1.45 million and a total of $4.8 million since the announcement of our share buyback program last year in November.

Now, I will give you an update on our staffing and solution businesses in conjunction with our focused areas of Europe, healthcare and diversified industrials.

Our staffing business which represents of 70% of total revenue, as I previously mentioned, faced weaker-than-anticipated demand at several large clients. These isolated areas of weakness are related to client specific challenges in the respective businesses, but we continue to observe positive indicators elsewhere in the market and across our broader client base. Importantly, our relationships with all of our large staffing clients remains strong and we continue to provide them with the reliable high value services and support they've come to expect from CTG.

In fact, during the quarter we continued to advance multiple new and potentially sizeable business opportunities at our largest staffing client. We believe that at least one of these new opportunities could lead to an engagement that could be a relevant contributor in the second half of 2017.

We've also continued to make meaningful progress on increasing our share of business at other existing clients. Most notable, we recently secured incremental work at an existing global IT management and services client that represents an opportunity to significantly expand our North America footprint. We've allocated an initial small group of individuals, and we're in the process of transitioning from another provider. And we expect to onboard a larger number of additional individuals in the coming months and quarters. This is a significant win for CTG, and we believe the incremental business has the potential to grow the account to a top-five staffing client overtime.

In addition to increasing business at existing clients, we've successfully grown the pipeline of targeted new business opportunities over the first half of 2017. Consistent with our strategic objectives, our primary focus continues to be on expanding CTG's client base in key geographies where we already have a strong market presence. And since our earnings call in April we've made significant progress towards finalizing engagements with a number of these prospective accounts. We believe some of these accounts have a potential to contribute to our second half results as well.

Shifting to an update on CTG's offshore delivery center in India where last quarter I talked about having implemented a number of operational improvements, both sourcing activity and bill rates have increased, and response times have improved. More recently, we began positioning resources in Hyderabad to deliver technical work as part of a planned proof-of-concept with an existing U.S. based client. Once proven successful, we believe there will be a significant opportunity to scale the amount of India based technical work we can provide to both current and prospective clients.

Turning to our solutions business, which is 30% of our revenue, most areas performed in-line with our expectations although we were down fractionally on a sequential basis. Our primary solutions offerings are application development and management, IT service desk, business process management, implementation and optimization as well as testing execution.

As I've highlighted on previous calls, the expansion of these solutions across all of the lines of business is a key strategic objective. In May, we achieved a significant milestone in support of this objective with our formal launch of Application Advantage. This new offering combines several of CTG's existing services into a single comprehensive solution that is designed to maximize the value efficiency and cost effectiveness of application services. In less than three months we've secured multiple client engagements, and our global sales team is now working to further expand this new portfolio of services.

In addition, the ONE CTG program we launched at the beginning of the year, encouraging enterprise-wide collaboration and established a framework for cross-selling is also demonstrating early signs of success. During the second quarter, proactive collaboration between separate business units within CTG resulted in implementing higher margin solution engagements beyond what would have typically been standard staffing agreements.

Now I'd like to provide a few highlights on the additional progress we made throughout the quarter within our three key focus areas which include Europe, healthcare and diversified industrials.

Beginning with Europe, our business was effectively flat on a sequential basis with revenue of $18.9 remaining near the two-year high and record percentage of total CTG revenue achieved in the first quarter. Our stable client base in Belgium, Luxemburg and the U.K. continues to be a solid foundation to further grow market share in the respective geographies.

During the quarter the team added a double-digit number of new accounts for the sixth consecutive quarter including our first EMR implementation for a French speaking hospital in the Walloon region of Belgium. Although implementations in Europe were smaller engagements than those we've historically seen in the U.S., we've now signed a total of eight contracts, some of which also include Application Advantage support services as a follow-on offering.

Additionally, we are experiencing strong demand for our software testing capabilities in Belgium, and the team is now actively working to build out and grow CTG's cloud service and data protection offerings. Overall, our pipeline of new business in Europe continues to expand in terms of both the number of opportunities and the aggregate dollar value. As we look to the second half of the year, we have currently submitted proposals on a number of meaningful opportunities within the European Ministry, EMR implementations as well as other potential work in the financial and government sectors.

Moving to healthcare, we've narrowed the geographic focus of each salesperson and are concentrating these focus areas in regions where CTG has strong existing support resources. Combined with a newly implemented strategy for lead generation, this more focused centralized sales approach enables us to better leverage relationships we have developed over the years with our healthcare clients. Although revenue from this business has been stabilizing over the past four quarters, we took decisive action during this quarter in order to drive a more meaningful turnaround in the performance of the business.

In addition to consolidating certain resources and continuing to strengthen leadership across the organization, we recently expanded our sales team and made a number of enhancements to our sales approach. Each of these actions were motivated by our objective to consistently improve effectiveness throughout the organization. Our improved pipeline is an early indicator of success.

Collectively these actions establish a fresh foundation of strategy for renewed growth in healthcare and continue to represent an attractive and strategic market opportunity for CTG.

Finally, in our diversified industrials business, which spans multiple different sectors, we are consistently uncovering and pursuing new opportunities to further leverage this proven platform which consists of a unique team of highly-skilled solution architects and software engineers. Year-to-date, we have secured and extended several meaningful engagements with both corporate and government clients as well as advanced multiple strategic partnerships to either co-sell or re-sell complementary services and solutions.

On our last call I highlighted a new staffing agreement with a global engineering and construction firm. We are currently working to build out a custom solution for this new client that has the potential to contribute meaningful growth once fully ramped. We also recently completed an agreement with a software vendor that complements our significant depth in business process management. A number of our employees are now becoming certified in this software to provide a high level consulting service and bring this solution to a growing list of prospects. Collectively, we continue to be optimistic about our ability to grow the diversified industrials organization in the coming quarters.

In conclusion, in 2017, we have achieved some significant accomplishments including formalizing a definitive three-year strategic plan for growth, upgrading and expanding our sales organization, flattening the organization to drive efficiencies and improve performance, adding a new board member with extensive IT service experience, and directly aligning the executive leadership team with shareholders with performance based equity grants.

These are just a few of the ideas we accomplished this year along with the others previously mentioned on this call. We have been building a foundation for growth, and our strategy is working. We believe that the overall market environment remains favorable, and we are better positioning the company to capture incremental market share. In fact, today we have the largest pipeline of proposals that the company has had in recent history, and I am very optimistic about the progress we are making to advance our growing number of opportunities with both new and existing clients. As we look to the second half of 2017, execution remains paramount and is a company-wide focus. Our priorities continue to be on re-establishing top-line growth and diversifying CTG's client base while also carefully managing expenses to preserve near-term earnings.

Longer term, we remain committed to our strategic plan and driving incremental improvement towards achieving or to exceeding our three-year financial objectives.

With that, I will turn the call over to John for discussion of our financial results and guidance.

John Laubacker. Thank you, Bud. Good morning, everyone. We appreciate you joining today's call. As we indicated in this morning's news release, revenue in the second quarter was $75.5 million compared with $77 million in the first quarter of 2017 and $83.5 million in the second quarter of 2016. Negative currency translation reduced second quarter 2017 revenue by approximately $600,000. We had 64 billing days in the second quarter of 2017, the same number of days as in the year-ago quarter.

Staffing revenue in the second quarter declined by approximately $1.1 million or 2% from the first quarter of 2017 and declined by $5.9 million or 10% year-over-year. Lower revenue in the second quarter of 2017 primarily reflected a combination of weaker demand in the quarter at several accounts and delayed purchase orders at a large staffing client.

Revenue from our solutions business in the second quarter declined sequentially from the first quarter by approximately $400,000 or 1.8% and declined by $2.1 million or 8.5% compared with the year ago quarter. Revenue from IBM in the second quarter was $19.0 million or 25.1% of total revenue compared with $20.3 million or 26.4% in the first quarter of 2017 and $25.1 million or 30.1% of total revenue in last year's second quarter. Revenue from Lenovo in the second quarter was $9.4 million or 12.5% of total revenue compared with $9.4 million or 12.2% in the first quarter of 2017 and $8.3 million or 10% of total revenue in the second quarter of 2016.

Direct costs, which included severance related cost of $400,000, were 81.9% as a percentage of revenue in the second quarter of 2017 compared with 81.5% in the previous quarter and 80.9% of revenue in the second quarter of 2016. Direct cost in the year-ago quarter benefited from approximately $700,000 in foreign payroll tax credits.

On a non-GAAP basis, excluding the severance costs from the 2017 second quarter results in a direct cost percentage of 81.4%, while excluding the foreign payroll tax credits from the 2016 second quarter results in a direct cost percentage of 81.8%. GAAP SG&A expenses were 17.1% of revenue in the second quarter and include approximately $400,000 in severance related charges. On a non-GAAP basis, SG&A expenses were 16.6% compared with 16.8% of revenue in the first quarter of 2017 and 16.8% of revenue in the year-ago quarter. On a non-GAAP basis, second quarter 2017 SG&A expenses were $1.5 million lower than the year-ago second quarter.

Second quarter GAAP operating income was $700,000 or 0.9% of revenue which included $800,000 in severance-related charges. Non-GAAP operating income in the second quarter was $1.5 million or 2% of revenue, compared with operating income of $1.3 million or 1.7% of revenue in the first quarter of 2017. Operating income in the second quarter of 2016 was $1.9 million or 2.3% of revenue but benefited from the foreign payroll tax credits previously mentioned.

The effective tax rate for the second quarter of 2017 was 33.2% compared with 41.2% in the first quarter of 2017 and an effective tax rate of 29.6% in the second quarter of 2016. GAAP net income in the second quarter of 2017 was $434,000 or $0.03 per diluted share, which included $600,000 in severance-related charges. Non-GAAP net income in the second quarter of 2017 was $1 million or $0.06 per diluted share compared with net income of $751,000 or $0.05 per diluted share in the first quarter of 2017. Net income was $1.3 million or $0.08 per diluted share in the second quarter of 2016 and included a $0.03 per diluted share benefit related to the foreign payroll tax credits.

Second quarter 2017 results included equity based compensation expense of approximately $0.01 per diluted share net of tax. CTG's headcount at the end of the second quarter was approximately 3,400 compared with 3,300 at the end of the first quarter 2017 and 3,500 at the end of the second quarter of 2016. Approximately 90% of our second quarter 2017 employees were billable resources, consistent with the percentage at the end of 2016.

Turning to our balance sheet, cash and short-term investments at the end of the second quarter were $11.5 million, and outstanding long-term debt was $3 million. Day sales outstanding were 82 days in the second quarter of 2017 compared with 81 days in the year-ago second quarter. The cash surrender value of life insurance was $31.8 million at the end of the quarter.

We continue to list our three-story office building for sale. The office building has a net book value of $1.7 million and remains on the marketed at an asking price of $3.2 million. The company's other property is no longer on the market, and our ultimate goal continues to be combining our Buffalo-based employees into a single building here in Buffalo. We estimate that consolidation into a single building could reduce our annual operating expenses by approximately $500,000.

CTG's tangible book value at the end of the second quarter was $5.01 per share.

During the second quarter of 2017 the company repurchased 257,000 shares at an average price of $5.63 per share for a total cost of approximately $1.45 million. We repurchased approximately 53,000 additional shares subsequent to quarter end and as of today have approximately $5.2 million remaining under the existing repurchase authorization.

Turing to our guidance, we anticipate total revenue in the third quarter of 2017 to be in the range between $75 million and $77 million. Third quarter operating margin is expected to be between 1.6% and 1.8%. In addition, we expect third quarter net income to be in the range between $0.04 and $0.06 per diluted share. There are 63 billing days in the third quarter of 2017, the same number of days as in the year-ago third quarter. The effective tax rate for the third quarter is expected to be approximately 36%. Please note that our reported net loss of $1.03 per diluted share in the third quarter of 2016 included goodwill impairment charges of $1.01 per share as well as severance related charges of $0.06 per diluted share.

For the full year 2017, we anticipate revenue to be in the range between $305 million and $315 million. Non-GAAP operating margin for the year is expected to be approximately 2%. Full year non-GAAP net income is expected to be between $0.22 and $0.26 per diluted share. Finally, we expect the effective tax rate for the full year 2017 to be approximately 36%.

Our revised full-year revenue guidance reflects the weaker demand we experienced in the second quarter at several of our larger staffing clients combined with the unexpected delay in issued purchase orders from one of our largest clients. Importantly, we are maintaining the midpoint of our full-year earnings guidance. Our expectations include ongoing diligent cost management as well as continued investments in business development and recruiting resources. We remain absolutely committed to driving growth and profitability and continue to be encouraged by the number and quality of opportunities in our pipeline. The progress we are making to secure new clients and projects together with the strength of our customer expansion opportunities makes us optimistic that we will return to revenue growth by the end of the year.

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

Operator. Certainly. Our first question comes from the line of Vincent Colicchio with Barrington Research. Please go ahead.

Vince Colicchio. Good morning, guys. Bud, I'm curious about the additional work that you won at an existing IT services client versus another provider. What do the margins look like on that work? Was price a meaningful factor, and are there other opportunities like that?

Bud Crumlish. Well, transitioning current employees from another provider, that's always at a lower price, but we got the combination of both here. We did a special arrangement to do that as well as support them for their new requirements which would be at higher margin. I'm really not at liberty to say what the particular margins are on this, but that's typically how it works standard in the industry.

Vince Colicchio. And you said that your pipeline is the highest in recent history. I am curious, is it a meaningful increase versus the year-ago period, for example?

Bud Crumlish. I would say absolutely it's a meaningful increase in our pipeline. We are seeing a lot of activity. We're getting RFP proposals in, and some of these are significant and I'm very optimistic about them. Obviously we have to close them. We have to execute on them, and sometimes it takes time to ramp up, but now I am very optimistic about them. We haven't had something like this in I can't tell you how many years but a number of years.

Vince Colicchio. It sounds you have got a good amount of potential for upside in the second half versus your expectation. Would you say that you're being conservative with your expectations for the second half?

Bud Crumlish. Until we have things locked down it's hard to actually put that in our guidance number. That's the thing. We need to close a lot of these. We need to execute on them, and then that's going to make a difference. But to put it in our guidance now, we don't feel it's prudent at this point.

Vince Colicchio. On the regulatory front, are you seeing any negative impact from uncertainty in the financial services and healthcare sides of things?

Bud Crumlish. I would say, no. We don't really see anything negative. Like I said, I am pretty optimistic. I always look at proposal levels and requirements and things like that to drive business, and with all that, we're going strong. Like I said, we've never had a higher pipeline. We have made some changes operationally with our recruiting organization so we can respond faster with high quality candidates. So we really haven't seen anything.

Vince Colicchio. Okay. Thanks, Bud. I will go back in the queue.

Operator. Our next question comes from the line of Kevin Liu with B. Riley and Company. Please go ahead.

Kevin Liu. First question I had was just on the delayed purchase orders from the large customer. Any sense you can give us in terms of kind of the value of those purchase orders or perhaps just kind of what percentage you since have been able to close? To what extent is the assumption made that you are going to close the remaining value of that and have that be able to help make your guidance for the full year?

John Laubacker. Kevin, it had a very significant impact on the quarter. We tend to be pretty realistic and conservative as we put our guidance forth. So you know that we were below our midpoint of our guidance for the second quarter, and the impact of these delayed purchase orders have very significant direct impact on us not being in the range in the quarter. From where we have been to date since this initially happened, a number of those POs have been released. There are a number that are still on hold at this point in time, and we have been told that the expectation is that they will be released at some point in the future this year but haven't been given the clarity as to when that will be.

Kevin Liu. So have you guys assumed any sort of contribution from the delayed POs in terms of either your Q3 or Q4 guidance? And then beyond that you talked about other large opportunities that could start to contribute in the second half. From your earlier comments I would assume you haven't baked those into your guidance but just wanted to clarify.

John Laubacker. We have been pretty conservative with the release of the remaining POs that are on hold, so we have baked them in, but again, we didn't do that as of, for instance, July 1st to start the third quarter. So we have been pretty conservative. I can let Bud speak a little bit more to the large opportunities, but as he just indicated, we were very conservative with that. We have a number of great opportunities in front of us which we feel very positive about. But until we convert proposals and opportunities and RFPs into wins, we tend to be pretty conservative about baking them into the forecast.

Bud Crumlish. Yes, we like to see progress along the line of escalating through the sales funnel, and we are in that process. As we get closer and feel more confident and comfortable, then that makes a difference in our guidance on what we will come out with. But right now, like I said, we have a really strong pipeline that I haven't seen in years, but as John mentioned, we are being conservative about our guidance with that. So we are holding back until we get further information, make further inroads and understand exactly when things could start and when we can close it.

Kevin Liu. Understood. With respect to the large pipeline, could you just speak to whether that's concentrated with a handful of larger opportunities or whether you feel it's pretty well diversified amongst end customers?

Bud Crumlish. I would say there is a lot diversification with it, but there definitely are some large opportunities in there with some larger clients, absolutely. It's really a combination of both.

Kevin Liu. And then, just lastly from me, on the Application Advantage side, you talked about some solid initial traction. Maybe if you could talk about kind of the average deal sizes that you have been able to secure to date and whether those start to contribute this year or do they have some sort of ramp up here before you get more meaningful contribution?

Bud Crumlish. Those would be definitely included in this year. Deal size, it's kind of hard to say. It's a pretty wide range. I mean you can go from \$1 million to \$10 million. So it's a pretty broad range and multiple years as well.

The one thing also just to mention, when we have done our EMR implementations in the U.S. over the last number of years, when we're done with the implementation, we're done with the implementation. One of the things that we have with Application Advantage is that in Europe they are going to need follow-on application support so although there is an initial surge in revenue to get the implementation done over a year or 18 months, we have continuous follow-on work for a long period of time, typically three to five years. So that's another benefit to us. I mean we are just starting these implementations in Belgium, but that's a real plus in mind that we can use the same resources that implement to actually support and on the tail end to find continuous revenue stream for a longer period of time.

Operator. Currently we have no further questions in queue.

Bud Crumlish. Thank you, Ryan. To close out the call, I want to state that we have laid the foundation for growth and profitability to drive shareholder value, and we see significant progress across all the lines of business. We continue to take decisive action and remain intently focused on execution in line with our strategic plans.

We will make the required investments to re-establish top-line growth and diversify our client base while continuing to diligently manage cost to preserve near-term earnings. We appreciate you joining today's call, and I also want to thank all of our shareholders for your continued support. We look forward to reporting additional progress next quarter. Ryan, you may now disconnect the call. Thank you.