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

Jim Culligan. Thank you, Brad, and good morning, everyone. With me on today's call are Bud Crumlish, CTG's President and Chief Executive Officer, and John Laubacker, Executive Vice President and Chief Financial Officer. Also joining us today is CTG's incoming CEO, Filip Gydé, who is currently Executive Vice President, General Manager and President for CTG's European operations.

Before we begin, I wanted to mention that statements during the course of this conference call that state 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, February 19, 2019. 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 today's earnings release as well as in the company's SEC filings.

Also, the company's press release and management statements during the call include discussions of certain adjusted non-GAAP measures and financial information. These financial measures and a reconciliation of GAAP and 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. Good morning to everyone joining us on the call. I'll begin this morning with a brief overview of the fourth quarter.

Revenue for the fourth quarter increased 3% sequentially and approximately 25% year-over-year to $93.1 million, above the midpoint of our guidance range between $89 million and $94 million. Growth was primarily driven by two key factors. First, the continued strength and outperformance of our organic European operations, which also benefitted from a strategic acquisition of Soft Company in early 2018. Second was our increasing traction in Health Solutions, where we continue to secure new client wins as well as expand the scope of contracts with existing clients, following a successful repositioning of this business to address the healthcare industry's transition to value-based care.

For the full year, consolidated revenue increased 19% to $358.8 million, within our expected guidance range as stated in our third quarter earnings release, and near the high end of our range of $360 million that we established in early 2018. Throughout 2018, we continue to make significant progress in positioning our business for long-term growth. We executed a number of strategic growth initiatives and made investments to realign certain areas of CTG's business, which have established a solid foundation to generate sustainable growth and profitability.

Our year-over-year top line results reflect these successful efforts, and also our continued outstanding performance and operational excellence in Europe. We enter 2019 with significant momentum. When we established our strategic targets in 2017, we targeted to achieve these by the end of 2019. These were ambitious targets, with an aggressive timeline, and we may not meet all of our goals by this coming year-end. That said, we have absolutely made significant progress towards achieving our long-term goals. We remain confident that we can accomplish these targets in an extended time frame and continue to believe we need to make additional investments to drive the long-term success of the company.

During 2018, we made significant investment in business development, recruiting, and marketing in North America to position the company for improved growth and profitability. As we indicated in today's press release, the time frame of these recent investments has not yet allowed us to see all the positive operating results that we are expecting from these investments. This required us to incur a non-cash charge for taxes in the fourth quarter, which John will discuss as part of his remarks.

More broadly, our three-year strategic plan that we announced in early 2017 outlined a series of objectives designed to drive fundamental improvement in specific areas of the business, including business development, healthcare, European operations, our staffing business, solutions offerings, and our cost structure. We continue to execute against our target by advancing operational excellence, augmenting organic growth with strategic acquisitions, and enhancing shareholder value.

We've also focused dedicated efforts on corporate governance over the past several years to further align the company with the interests of CTG's shareholders. The company and its board have taken specific actions to create sustainable value for shareholders. These included, in 2018, we used $14.9 million to repurchase a total of 1.8 million shares of CTG common stock through both a tender offer for 1.5 million shares and our existing share repurchase program. As of December 31, 2018, we had approximately $7.7 million remaining under our existing repurchase authorization program. We expanded the company's existing share repurchase authorization by $10 million, providing additional capacity for potential future share buybacks.

We eliminated cash compensation for all non-employee directors in favor of providing applicable compensation exclusively in CTG shares to further align interests with shareholders.

And we continued the innovative equity-based compensation program for our senior leadership consisting of grants and associated vesting based upon a significant increase in share price.

We will continue our efforts to evaluate and consider new initiatives in 2019 to demonstrate best practices in corporate governance and maintain strong alignment with and enhanced value for our shareholders.

Now I move to the recent developments in our Solutions business. Our Solutions business continues to be a key strategic area in which we have invested over the past two years. In the fourth quarter, revenue from Solutions expanded 28% year-over-year to $29.9 million, representing approximately 32% of consolidated revenue compared with 31% of revenue in the year-ago quarter. We remain focused on increasing the mix of higher-margin solutions as a percentage of CTG's overall business. The pipeline of potential solutions opportunities continued to increase in the fourth quarter, and given our historically strong conversion rate, we expect this to lead to incremental and profitable new business engagements and contracts in the coming quarters.

As we expected, the successful implementation of our ONE CTG initiative has led to stronger collaboration across our business and growing traction in our service offerings. This initiative also led to the development and launch of a second important solution in 2018, which is Enterprise Information Management, or EIM. While our Application Advantage solution launched in 2017 enables clients to maximize value, efficiency, and cost effectiveness of their application management, EIM allows clients to capture, manage, analyze and transform data into actionable information. Both of these innovative solutions offerings have already generated a series of new client wins, and we expect them to help shape additional offerings for our clients in the future.

Looking specifically at our European operations, we maintain the trend of delivering consistent growth as this area of the business continues to perform at or above the broader market. In the fourth quarter, revenue from Europe grew 46% year-over-year to $33.9 million and represented 36% of consolidated revenue as compared with 31% in the year-ago quarter. We converted a double-digit number of new clients from our expanding pipeline of new business opportunities, where we are specifically seeing ongoing notable success within the financial sector and European institutions. This positive development also led to an increase in our service provider headcount during the quarter.

Further complementing this organic growth was the continued strong performance of the business we acquired in France in early 2018, Soft Company, which continues to be a meaningful contributor to the combined outstanding performance of CTG's European operations. Earlier this month, we completed the acquisition of Luxembourg-based Tech-IT at a very attractive purchase price of around 0.5 times sales, excluding potential earn-outs. We expect this strategic transaction to add approximately $20 million in annualized revenue, provide us with complementary solutions offerings, expand existing and new client relationships, and immediately contribute to our operating results in Europe.

Most importantly, we were able to fill a gap in our existing portfolio by providing hardware and software-based solutions. We are now able to offer full end-to-end IT solutions, including cloud services capabilities, to current and prospective clients in Europe. In the long-term, we expect this acquisition to deepen our existing market penetration across the financial services and local government sectors in Luxembourg and add complementary strategic solutions in the areas of consulting, project management, training, and infrastructure integration.

Taken together, both of the acquisitions we've made over the past 12 months expand CTG's footprint in Europe, broaden our portfolio of service offerings, and increase our mix of high-margin solutions business. They also provide significant cross-selling and revenue synergy opportunities and deepen penetration with new and existing markets. While there is additional work to be done to integrate and realize their full benefit, both transactions are consistent with our strategy of making focused investment in the highest performing areas of our business.

Turning to CTG's Health Solutions business, revenue grew substantially in the quarter and represented a third consecutive quarter of growth. We finished the year with a solid pipeline of new business opportunities that will aid in driving further positive results in 2019. During the quarter, our team successfully booked incremental new business and converted or extended a number of engagements into secured contracts, in particular, two new important Health Solutions clients, which include a major healthcare network on the East Coast and a large Midwestern State University system.

As I've already indicated, our Health Solutions team continues to demonstrate increasing successful progress following our repositioning of this business to capitalize on the healthcare industry's ongoing transition to value-based care. That is supported by our efforts to increase and concentrate our marketing activities towards the sale and delivery of solutions, such as our ongoing efforts to further promote our Application Advantage and EIM solutions. Our previously announced win and subsequently expanded contract with Catholic Health Initiatives, CHI, which today represents one of the CTG's largest Health Solutions clients, is one of the examples that reflects our success and the effectiveness of these ongoing initiatives. Overall, the positive momentum we are generating within our Solutions business is encouraging and should increasingly contribute to future financial results.

Now turning to our Staffing business. Fourth quarter revenue grew 23% year-over-year to $63.2 million, representing approximately 68% of consolidated revenue. Growth continued to be driven primarily by expanding business with large existing clients. In fact, we are regularly being considered by many of our long-term clients for incremental business and expanded scopes of work, which is a strong testament to CTG's deep personal relationships with our clients, strong market presence and our proven track record of delivering reliable service.

In addition to better positioning and supporting our existing clients, we remain committed to our strategic approach of realigning our North America Staffing business for more diversified and profitable growth. As evidence of our most recent progress with new clients, we added six first-time accounts during the fourth quarter. Over the course of 2018, we invested in numerous actions to refocus resources and drive increased operational efficiency, and also made significant investments in business development to better capture new value-add business with higher margins.

As I've already mentioned in my opening remarks, the benefit we are expecting from a number of these recent investments have not yet fully materialized and improved results for our North America operations. Importantly, we remain committed to targeting sustainable higher margin opportunities in our North America Staffing business as we recognize more meaningful returns on our investments combined with greater operational efficiency in order to improve future operating results.

One of our highest priorities for 2019 is to enhance our performance in this area of our business, and I'm confident that we are well-positioned with a strategic plan to meet our goals. This is in line with my priority over the last few months of a seamless transition across all of our business aspects, as I have announced in December, my retirement from CTG after 28 years and the appointment of Filip Gydé as the incoming CEO beginning March 1st. I would like to use this as an opportunity for Filip, who has had a successful nearly 30-year career with CTG so far, to introduce himself, before turning the call over to John for a detailed review of the financials.

Filip Gydé. Thank you, Bud. It's my sincere pleasure to join you along with John and Jim on today's call. Good morning to everyone on the phone. I would like to provide a brief overview of my background and why I'm excited to lead CTG.

I joined CTG in 1990 and have served in a number of executive leadership roles with the company. As Jim mentioned at the beginning of this call, most recently I have been serving as Executive Vice President, General Manager and President for CTG's European operations, which today represents roughly one-third of CTG's consolidated revenue. In this role, I've successfully led CTG's European business during a period in which we achieved nine consecutive years of growth. I firmly believe this accomplishment is a result of strong teamwork in developing and executing sound business strategies at the right time and with the right people. My prior experience overseeing CTG's global operating activities and serving as Managing Director of CTG Belgium has helped to shape and sharpen my current approach for generating sustainable and profitable growth.

Since the announcement in December, I have been working closely with Bud and senior management as part of the transition process, which is going very well. Upon assuming the CEO role on March 1st, my first priority will be to further refine our key growth initiatives to drive improved company-wide performance and replicate the success we've consistently demonstrated in our European operations. As part of these initial objectives, I will also focus on achieving requisite returns on our strategic investments as well as enhancing our operating results, particularly within the staffing business in North America.

We have taken numerous steps over the last two years to expand our IT solutions offerings and realigned the focus of our staffing services. Our continued execution on those ongoing initiatives is critical to the future performance of our overall business. Additionally, we expect to realize improving returns from our significant investments in business development for higher-margin solutions as well as from the two recent strategic acquisitions that expanded the depth and breadth of the solutions we offer to our clients.

I am certain that the current trajectory we're on is the right one. I am encouraged by the progress we've made over the last few years, and I'm confident in the future of the company. I look forward to leading our highly capable teams as we pursue the next level of growth and realize CTG's full potential.

With that, I will hand over the call to John for a review of the financials.

John Laubacker. Thank you, Filip, and good morning to all of you joining us on today's conference call. As reported in this morning's press release, consolidated revenue in the fourth quarter was $93.1 million compared with $90.3 million in the third quarter of 2018 and $74.6 million in the fourth quarter of 2017. Currency translation had a negative $1 million impact on revenue in the fourth quarter. Billable days in the fourth quarter were 64, compared with 63 days in both the third quarter of 2018 and the year-ago fourth quarter.

Solutions revenue in the fourth quarter of 2018 was $29.9 million, which was up 3.5% compared with $28.9 million in the third quarter. Year-over-year Solutions revenue increased 27.6%, reflecting continued strength and momentum in our European operations, the ramp-up of several new Health Solutions engagements, and the expanded scope of business with several existing clients during the quarter.

Staffing revenue in the fourth quarter was $63.2 million, increasing 3% sequentially compared with the third quarter. Year-over-year staffing revenue grew 23.5%, driven primarily by incremental new business at large existing clients as well as some contribution from several smaller new accounts.

Revenue from IBM in the fourth quarter was $20.1 million, or 21.5% of total revenue, compared with $19.8 million, or 22% of total revenue, in the third quarter of 2018 and $18.5 million, or 24.8% of total revenue, in last year's fourth quarter. No other client represented more than 10% of revenue during the fourth quarter of 2018.

Direct costs as a percentage of revenue were 81% in the fourth quarter of 2018, compared with 80.8% in the third quarter of 2018% and 79.7% of revenue in the year-ago quarter.

GAAP net loss in the fourth quarter of 2018 was $5.3 million or $0.39 per diluted share, which included $0.06 per share in acquisition-related and severance expenses and $0.36 per share in tax-related items. I'd like to spend some time providing additional color on the $0.36 per share of additional tax items.

In 2018, the company made significant investments totaling nearly $3.5 million in our North American operations, primarily in the areas of leadership, business development, recruiting and marketing. These investments were made to drive long-term sustainable revenue growth and improved profitability. A portion of these investments has not yet materialized in bottom line results. As a result, we determined that the company may not be able to utilize this deferred tax assets in North America, and we're required to establish a full non-cash reserve against these assets totaling $3.8 million or $0.29 per share in the fourth quarter of 2018. Of the remaining $0.07 per share, $0.05 relates to the Global Intangible Low-Tax Income, or GILTI, provisions of the 2017 Tax Cuts and Jobs Act, and the balance related to non-deductible acquisition-related costs in our European operations following our acquisition of Soft Company in February 2018.

The fourth quarter of 2018 GAAP net loss of $5.3 million, or $0.39 per share, compares with GAAP net income in the third quarter of $1.2 million, or $0.08 per diluted share, which includes $0.04 per share of acquisition-related expenses and $0.06 per share non-taxable gain from life insurance proceeds. GAAP net loss in the year-ago quarter was $419,000, or $0.03 per diluted share, which included a $0.11 per share non-cash charge related to the change in U.S. tax law and a $0.02 per share non-taxable gain from life insurance proceeds.

The effective income tax rate in the fourth quarter of 2018 was 449% compared with 22% in the third quarter of 2018 and 123% in the year-ago quarter. The effective tax rate for the fourth quarter of 2018 reflects the previously discussed reserve for U.S. deferred tax assets, costs related to the GILTI provisions of the 2017 Tax Act, and non-deductible acquisition-related costs in our foreign operations.

CTG's total headcount at the end of fourth quarter was approximately 4,150 people, compared with 4,150 at the end of the third quarter of 2018, and 3,400 at the end of the year-ago fourth quarter. The increase from last year is primary related to the Soft Company acquisition in February 2018, organic growth in Europe, and growth in Staffing services from our largest clients. Approximately 91% of our fourth quarter 2018 headcount was billable.

Turning to our balance sheet. Cash and cash equivalents at the end of the fourth quarter was $12.4 million. We had $3.6 million of outstanding long-term debt. Capital expenditures in the fourth quarter were $381,000, compared with $610,000 in the third quarter.

One brief note related to CTG stock repurchase program. Given that our recently completed acquisition of Tech-IT was pending material information until publicly announced in January 3rd of this year, the company was restricted from repurchasing shares during most of the fourth quarter of 2018. At year-end, we had approximately $7.7 million available under the existing repurchase authorization.

Turning to our guidance, as reflected in this morning's press release, beginning in 2019, the company will only provide full-year guidance for revenue, GAAP, and non-GAAP diluted earnings per share. For full year 2019, revenue is expected to range from $380 million to $410 million, GAAP net income is expected to range from $0.20 to $0.30 per diluted share. Excluding certain anticipated acquisition-related expenses associated with the previously completed transactions, non-GAAP net income is expected to range from $0.30 to $0.40 per diluted share.

As indicated by our comments on today's call, we are continuously evaluating and taking steps to improve the performance of the business and our operations. We are very pleased with our progress over the last year to generate meaningful year-over-year top line growth, and we are focused on improving our bottom line through the continued expansion of our solutions business by adding higher margin clients in our North American Staffing business. Our past actions have provided CTG with a solid foundation to begin 2019, and we are confident about demonstrating further progress in the year ahead and beyond.

With that, we'd now like to open the call for questions. Brad, can you please manage our question and answer session?

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

Vince Colicchio. Bud, I was hoping you could give us some color on the staffing side, in terms of the mid-market. I assume you're going to be stepping up investments in that area. I wonder if there's anything in the pipeline that could turn into business in the next 12 months on that side.

Bud Crumlish. Yes, Vince, we still have a solid pipeline in our, so to speak, mid-market, though they're not really large. I'm not saying, we don't have a focus on the large ones, but it's really more towards the mid-market where we're really focused on to get higher value. That certainly is coming in. With every month, we're increasing our possibilities of driving more business there.

So it's promising, and in some of the areas where some of our investments haven't paid off, a lot of it has got to do with timing. It takes a certain amount of time before somebody gets up the speed, and certainly, we expect positive outcomes throughout the entire year.

Vince Colicchio. John, what is the embedded gross margin expectation for the year of 2019?

John Laubacker. The direct margin for '19 is just over 19%. A little bit higher than it was in 2018.

Vince Colicchio. On your comments on taxes, I got that the deferred tax was the biggest piece. What were the other two pieces? Can you repeat that?

John Laubacker. The two other pieces totaling about $0.07 per share were the GILTI provisions of the 2017 Tax Act, which was about $0.05, and we had about $0.02 of non-deductible acquisition-related costs in our European operations from the acquisition of Soft Company.

Vince Colicchio. The deferred asset size was $0.29. Is that what you said?

John Laubacker. That's correct.

Vince Colicchio. So if you pull everything out, your taxes were then basically zero, right?

John Laubacker. Well in total there was about $0.36 in the quarter in tax-related impact.

Vince Colicchio. Bud, IBM, it's still pretty big account. We had a slight uptick in the quarter. What's the outlook for 2019?

Bud Crumlish. Well, we don't have a specific number for the outlook but our relationship has never been better; it's very strong. We've got additional business. We're working with them on a regular basis, a daily basis, and then we've done an introduction with Filip to them, to continue on the progress we've made. Certainly this past year, we've made, I think, a lot of progress there, and they're doing well in the particular areas that we're going after. So, I expect more positive momentum to continue through the future, certainly through this next year.

Vince Colicchio. One last one from me, Bud. If I remember correctly, with Soft Company, one of the reasons you are excited about that deal is you had some existing accounts in France you thought you could sell into. How is that going?

Bud Crumlish. I think, it's going great. In fact, why don't I just turn that one over to Filip since he knows the specific accounts; he's been intimately involved?

Filip Gydé. Yes, Vince. When looking at Soft Company, the reason why we did this acquisition was basically, in the financial sector, we were seeing the same accounts like we have already in Belgium and in Luxembourg but now the headquarters of those accounts are in France, in Paris, which gives us a lot more leverage. Obviously, when you're selling in the country where the headquarters is you're higher on the food chain, and it's actually already helped us with our business in Belgium and in Luxembourg, and it strengthened our position in the Paris headquarters of a couple of accounts. So, that's actually starting to already deliver returns of synergy that we had anticipated.

Vince Colicchio. Thanks for answering my questions, guys.

Operator. We do have a question from the line of Zach Cummins with B. Riley FBR. Please go ahead.

Zach Cummins. Good morning, thanks for taking my questions. So just starting off, there was pretty strong performance from both the Staffing and Solutions business during Q4, but can you talk about some of the things that really impacted the operating margins in 4Q?

John Laubacker. Sure, Zach, this is John. Really, it's part of what we talked about during the presentation and in the release. We have made a significant amount of investments in the organization throughout 2018, and some of those take time, as Bud indicated in his talking to Vince. So you've made investment today, you expect a return on that, we really expect 2019 to be great relative to those investments, but you incur the expense upfront and then you get a return at a later date. So those had a fairly significant impact on the operating margin at the end of the year.

Additionally, we had some severance costs associated with a variety of folks that was about $700,000 during the quarter and we had higher fringe benefit costs, or employee benefit costs, than we had anticipated as well. We didn't disclose that amount specifically, but what we do is we estimate those throughout the year, we true up that estimate on a monthly basis, on a regular basis, and when we got to the fourth quarter, we had significantly higher costs, primarily in medical, than we had seen throughout the rest of the year. So our estimates turned out to be a little bit low, which was really unusual. I don't think the estimating process was not complete or unusual, it's just that medical was far higher than we had planned. Those are the main things impacting the fourth quarter operating margin.

Zach Cummins. Understood. That's helpful context. And in terms of Europe, it's been a strong performer for CTG for quite a while now. Are there any concerns with the macro economy or any potential geopolitical events that could impact the business in the coming year?

Filip Gydé. Well, not really for Europe, where we're well-positioned. We have leading market shares in existing geographies. We have, through those two acquisitions, broadened our portfolio of service offerings, and those two acquisitions will only start to give us the returns we're looking for. I see them as seeds for future growth. It's expanding the depth and breadth of the offerings and expanding our client portfolio. As I said in the previous questions, Soft Company, while we see the start of revenue synergies with cross-selling, but we'll also see organic growth on what we started with in 2018. So in 2019, we expect further organic growth from Soft Company.

Tech-IT of course, it's very new so we'll need several quarters to materialize the synergy. But also there, the full benefits will layer-in over time, with those two. And Tech-IT is already immediately accretive excluding the acquisition-related expenses, of course. And those two are two new poles of growth added additionally to the organic growth, which we expect to still be strong this year.

Zach Cummins. That's helpful. And then last one for me. In terms of your guidance, how much contribution from Tech-IT is really embedded into that 2019 guidance? I'm not sure if you can provide any specific amounts, but just any sort of commentary around that—how much are you baking into your FY19 guidance and from Tech-IT at this point?

John Laubacker. We had estimated annual revenue for Tech-IT to be about $20 million based on a full year of revenue. We closed on February 6, so we've got about eleven-twelfths of an entire year. We did not disclose the margin specifically, but I will tell you that like Soft Company, one of the things that excited us about this opportunity is, excluding acquisition-related costs, it'll be accretive to what we're doing both in Europe and the U.S. overall. So, it will be beneficial and positive to our margins.

Zach Cummins. Well, thanks again for taking my questions and best of luck here in Q1.

Operator. At this time, there are no further questions in queue. I will turn it back over to the host for closing remarks.

Bud Crumlish. Thanks, Brad. Before closing out today's call, I wanted to reiterate that I'm pleased with the incremental progress we've accomplished over the past year to strengthen CTG and further position it for future growth. I firmly believe that the steps we've taken are the right ones.

Lastly, I want to express my sincere appreciation for having had the privilege of serving and having been associated with CTG for these past 28 years. This company has been a leader in providing the highest quality IT solutions and staffing services for more than 50 years, and I firmly believe CTG has the foundation in place to achieve sustainable and profitable growth for many years to come.

Under Filip's leadership, CTG's stakeholders should be confident that the company is increasingly poised for future success. Thank all of you again for joining us on today's call and for your continued support for CTG.