Operator. Ladies and gentlemen, thank you for standing by, and welcome to the CTG Quarterly Investor Conference Call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session, and instructions will be given at that time. As a reminder, this conference is being recorded. And I would now like to turn the conference over to your host, Mr. Jim Culligan.

Jim Culligan. Thank you, Tanika, and good morning, everyone. With me on today's call are Filip Gyde, CTG's President and Chief Executive Officer; and John Laubacker, Executive Vice President and Chief Financial Officer. Before we begin, I want to remind listeners that statements made 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 is 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, April 21, 2020. The company assumes no obligation to update these statements based on information from and after the date of this 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 the company's SEC filings. In addition, the company's press release and management's statements during the call 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 Filip for his opening remarks.

Filip Gydé. Thank you, Jim. Good morning to everyone joining us today on the phone and via webcast.

Our consolidated financial results for the first quarter were very good and in line with our prior expectations, despite the challenges related to the COVID-19 pandemic that emerged in March. The decline in total revenue year-over-year primarily reflected the anticipated near-term headwinds of one less billable day in first quarter, as well as our aggressive transition away from lower margin IT Staffing business.

During the quarter, we continued to make progress in our strategic shift towards a more solutions-centric organization, which was highlighted by the gross margin from our IT Solutions business expanding to 27.5%, an increase of 250 basis points year-over-year.

Combined with our prudent and ongoing cost management, we achieved an 80% increase in operating income for the quarter, and non-GAAP earnings per share increased by 67% compared with a year ago quarter.

Our first quarter results reflect the successful continuation of our transformational shift to a higher margin, solutions-first organization. The team remains focused on executing on our strategic plan, which continues to deliver solid results, as well as expanded margins and improved profitability.

Specific to the current environment, the majority of our business remains resilient throughout the first two months of the quarter. Beginning in mid-March, we saw increasing feedback from clients about the evolving impacts and business disruptions associated with the global COVID-19 pandemic. Without question, the two short months since our fourth quarter conference call has been extraordinary, and the scope of the impact on so many people's lives, company's operations, and the global economy has been unprecedented. My sympathy and well wishes go out to all those who have suffered loss or hardship associated with the pandemic. And I also want to thank all the people that are working so hard to protect and care for the well-being of all the communities in which we live and operate.

During these challenging times, the health and safety of CTG's employees, clients and business partners continues to be our top priority. As such, we took proactive and decisive action in response to the pandemic. The vast majority of our employees have successfully shifted to working remotely, while also complying with all national and local guidelines across CTG's operations in North America, Western Europe and India. Our highly talented team has demonstrated impressive flexibility, as well as the benefits of a modern mobile workforce, enabling us to quickly and safely adapt to the changing business landscape while fully meeting the needs of our clients.

In anticipation of the potential for a prolonged disruption to the global economy and increased uncertainty, we took a series of proactive steps to further strengthen the company's financial position. Our specific actions included securing additional liquidity by drawing down $12 million under our existing revolving credit facility and accelerating the collection of receivables from our largest IT Staffing clients during the first quarter, also totaling about $12 million.

In early April, we took measures to aggressively contain costs, consisting of a full furlough for a limited number of non-billable employees, and the 20% furlough for nearly all other non-billable employees, including senior management. However, we specifically excluded our business development and Global Solutions organizations as we continue to evaluate growth opportunities across our business. We have also eliminated all discretionary spending, and enacted a policy to restrict all business travel.

In Europe, we are actively participating in government-backed programs in Belgium, Luxembourg, and France, all of which provide assistance to largely offset the bench costs related to inactive employees. Even with the unprecedented challenges faced by companies across the globe, our team remains focused on maintaining a healthy pipeline of prospective business. We have continued to consistently pursue attractive opportunities for new and expanded solution engagements with our current and prospective clients.

In addition to submitting a steady volume of new proposals, we have continued to win meaningful new business. Recognizing that new business is critical to fueling future growth, we remained committed to investing in key areas across our sales and business development processes. During the first quarter, we supplemented our existing highly talented team by adding multiple experienced solution sales professionals to sustain our strong momentum.

In conjunction with our expansion of the sales team, we also implemented aggressive sales compensation plans for 2020 to further incent and reward new solutions related businesses. Despite the recent pandemic-related disruptions, in early April we secured a significant multi-year contract valued at over $5 million to provide application support for a new Health Solutions guidance. In addition, the same client has already come back after signing the initial contract earlier this month to evaluate the potential multi-million dollar add-on for additional training and support.

We continue to accelerate the ongoing successful transformation of CTG to solutions first organization. We have made strong progress towards our transformational shifts, and have positioned IT Solutions as the foundation for how we operate, and reliably deliver added value to our clients.

Central to these efforts is our ONE CTG initiative aimed at extending the capabilities of CTG’s core Global Solutions offerings – Application Advantage, EIM Advantage and testing solutions – and adapting our approach, offerings, and the delivery of our existing solutions to new regions and vertical markets.

In March, we successfully completed the acquisition of StarDust, a leader in testing and quality assurance for digital services, with operations in France and Canada. Although relatively small, with approximately $7 million in annualized revenue, the acquired business complements CTG's previous testing offerings in Europe with a complete range of testing service, including functional, multilingual, operational, environmental, regression, and application benchmarking.

StarDust also adds proven flexibility of service approaches with both in lab and on-site testers, as well as commercially proven crowd testing capabilities. In addition to strategically expanding CTG's testing solutions offerings and providing significant cross-selling opportunities at existing clients, the completed transaction is expected to be immediately accretive to operating results, excluding normal acquisition-related expenses.

We also simultaneously launched CTG's first offering of testing solutions in North America. Initially focused on the healthcare industry, this innovative new suite of solutions is modular by design, and can be customized to provide end-to-end testing services for both healthcare provider and payer organizations. Together, the launch of our new testing services and the acquisition of StarDust meaningfully expands our portfolio of offerings to address emerging clients, which we believe will contribute to accelerated growth of CTG solutions business in both North America and Europe.

As highlighted in this morning's press release, it is my pleasure to acknowledge and congratulate Rénald Wauthier on his recent promotion to Senior Vice President of CTG. Rénald is a 25-year veteran of CTG, and has demonstrated tremendous leadership in his past role while also being a fundamental contributor to the company's successful track record of growth and profitability. His extensive experience makes him the ideal leader to assume responsibility for CTG strategy and operations across all of Western Europe. Rénald's promotion also serves to complete the formal transition of my previous role prior to becoming CEO. We are confident in his ability to sustain CTG Europe's strength of outstanding performance, as well as successfully navigating the unprecedented challenges associated with COVID-19 throughout Europe.

Specific to the quarter, our operations and the overall business environment in Europe were very similar to what we experienced in North America. With a relatively softer start to the year, especially within the European financial sector, followed by a noticeably broader pause and increased uncertainty beginning in March. In spite of the challenging environment, our team successfully secured the double-digit number of new clients, including several key wins in Belgium and Luxembourg that contributed revenue in the first quarter.

We are also seeing an initial increase in demand and opportunities for our cloud-based solutions, which we believe has the potential for significant growth as a result of more companies having to adopt remote work environments for extended periods.

In IT Staffing, this area of the business performed relatively well in first quarter with increased needs across a small group of larger staffing clients, helping to offset the lower demand that might otherwise be expected as a result of the current environment. In fact, nearly the entire decline we experienced in the first quarter was from what we consider non-core staffing business, which can largely be attributed to our previously communicated decision to more aggressively transition away from certain lower margin business. We continue to fully support the needs of our existing staffing clients, while simultaneously remaining focused on prospective engagements in higher value areas, such as professional and IT staffing.

Acknowledging the heightened degree of uncertainty and potential for additional new challenges in the months ahead, I believe our entire organization has done an excellent job of rapidly adapting to the current business landscape, while continuing to provide highly effective support to our clients. We are closely monitoring CTG's business, employees and clients, and we will continue to proactively manage the factors that are within our control.

Most importantly, we remain focused on the disciplined execution of our strategic plan. As we manage our way through these challenging environments, a number of our core beliefs include:

- Our client base consists of many large, financially strong companies that have the ability to facilitate and manage the work from home environment;
- As we continue to see solid business development opportunities, we will continue to invest in sales and solutions experts to drive continued growth;
- We are focused on selling IT solutions and will leverage our long history of delivering to our clients, including remote;
- We believe the current environment will accelerate our transformation to an IT solutions organization as our non-core staffing positions will be reduced, and there will be a continued focus on delivering solutions remotely in the future; and
- While we are well capitalized, we can and will take additional actions as necessary to maintain liquidity and the overall financial strength of our enterprise.

I will now turn the call over to John for a detailed review of our first quarter results.

John Laubacker. Thank you, Filip, and good morning to those of you joining us on today's conference call.

As reported in our press release earlier this morning, consolidated revenue in the first quarter was $86.9 million, compared with $99.3 million in the fourth quarter of 2019 and $97.2 million in the first quarter of 2019. Currency translation had a negative $1.1 million impact on revenue in the first quarter of 2020.

Total days in the first quarter were 62 compared with 65 days in the fourth quarter of 2019 and 63 days in the year ago first quarter. IT solutions revenue in the first quarter of 2020 was $29.1 million, representing 33.4% of total revenue, compared with $33.4 million representing 34.4% of total revenue in the first quarter of 2019. While our IT solutions revenue declined during the 2020 first quarter due to several projects ending, consistent with our overall strategy our margin on this revenue improved approximately 250 basis points to 27.5% from last year's first quarter.

Revenue from IT staffing in the first quarter of 2020 was $57.9 million or 66.6% of total revenue, compared with revenue of $63.8 million for 65.6% of total revenue in the first quarter of 2019. The decrease in staffing revenue was due to our planned exit from some low margin non-core staffing business late in 2019, and in the 2020 first quarter. Revenue from IBM in the first quarter was $19.9 million or 22.9% total revenue compared with $21.5 million or 21.6% of total revenue in the fourth quarter of 2019, and approximately $20.9 million or 21.6% of total revenue in last year's first quarter. At this time, our master services agreement with IBM has been extended to May 1, 2020. And we anticipate it will be extended to June 30, 2020 in the coming days. No other client represented more than 10% of revenue during the first quarter of 2020 or in recent comparable periods.

Direct costs as a percentage of revenue were 80.4% in the first quarter of 2020 compared with 79.6% of revenue in the fourth quarter of 2019, and 81.8% of revenue in the year ago first quarter. In addition to the solutions-based business margin improvement, the margin on our staffing business improved 96 basis points year-over-year.

GAAP operating income in the first quarter of 2020 was 2.4% compared with 2.4% in the fourth quarter of 2019 and 1.2% in the year ago quarter. The non-GAAP operating margin in the first quarter of 2020, which excludes acquisition related expenses was 2.9% compared with 3% in the fourth quarter of 2019 and 1.5% in the year ago quarter.

The first quarter GAAP operating margin increased by 122 basis points and non-GAAP operating margin increased by 138 basis points year-over-year, with both measures remaining near multi-year highs despite a lower revenue base.

The effective income tax rate in the first quarter of 2020 was 39%, compared with 34% in the fourth quarter of 2019 and 33.3% in the year ago first quarter. The first quarter's rate was higher than the previous quarters primarily due to income in our European operations where effective tax rates are generally higher than those of the United States. GAAP net income in the first quarter of 2020 was $1.1 million or $0.08 per diluted share, which included $0.02 per diluted share in acquisition-related expenses. This compared with net income in the fourth quarter of 2019 of $1.7 million or $0.12 per diluted share which also included $0.02 per diluted share and acquisition-related expenses.

GAAP net income in the year-ago first quarter was $600,000 or $0.05 per diluted share, which included $0.01 per diluted share and acquisition-related expenses. Non-GAAP net income for the first quarter of 2020 was $1.4 million or $0.10 per diluted share compared with $2 million or $0.14 per diluted share in the prior quarter and $900,000 or $0.06 per diluted share in the first quarter of 2019.

CTG's total headcount at the end of the first quarter was approximately 4,000 compared with 3,950 at the end of the fourth quarter of 2019 and 4,350 at the end of the year ago first quarter. The quarterly decrease in headcount from year end primarily reflects the addition of StarDust, the testing solutions company we acquired in March. Approximately 91% of our first quarter 2020 headcount was billable.

Turning to our balance sheet, cash and cash equivalents at the end of the first quarter were $31.5 million, the highest balance in nearly five years, which reflected the drawing down of $12 million under the company's existing revolving credit facility, as well as the accelerated collection schedule we put into place with our largest staffing client. We ended the first quarter with $12 million of outstanding long-term debt, resulting in net cash of $19.5 million.

Capital expenditures in the first quarter of 2020 were $700,000 compared with $1.2 million in the fourth quarter of 2019, and $283,000 in the first quarter of 2019.

With that, I want to provide a few comments regarding our business outlook. Although COVID-19 pandemic had relatively limited financial impact on our business in the first quarter, we expect a more pronounced effect on both our clients' operations and CTG's business beginning in the second quarter. Therefore, given the heightened degree of uncertainty related to the magnitude and longevity of the anticipated future impact of the pandemic, we have chosen to suspend our previous full-year guidance for 2020. Together with CTG's board of directors and senior management we'll continue to closely monitor developments and as visibility improves, we'll revisit for your guidance.

Finally, before we move to the Q&A session, similar to last quarter I would like to remind everyone that we are here today to discuss the financial and operational results for the quarter and will not address the previous unsolicited offers to acquire the company. As in the past, our Board in consultation with its advisors will continue to review and evaluate any proposal to determine the course of action that we believe in the best interest the company and stakeholders. We ask that all questions remain focused on a reported results and current operations of the business.

Tanika, could you please manage our question and answer session?

Operator. Our first question comes from the line of Kevin Liu with K. Liu & Company.

Kevin Liu. It really didn't look like there was much of an impact from COVID-19 on your business in the first quarter. Can you just quantify if there was actually anything you saw with respect to any of your existing engagements, and through the first three weeks of April, what has changed in terms of how COVID-19 has impacted the business?

Filip Gydé. Sure Kevin, good morning. Looking at the pandemic and what's happened in the last four or five weeks, we really have seen mixed effects in both our North American and European operations.

Most of our employees now are in a work from home position, continuing their assignments. But we also have some clients and projects where it's not possible to work remotely due to the nature of the work we're doing with them, so their revenue has been adversely impacted. We also see some clients pushing project start dates out. That delays revenue on one side, but in some instances, has resulted in increased business as our legacy application management contracts were extended.

We have some helpdesk operations in our Health Solutions vertical that have expanded in response to an increase in patient's demands for access to their online medical records. And in this move to have everybody ready to work from home, we have helped some clients with their remote work capabilities, procuring laptops, setting up phone systems, etc. which helped us in securing and strengthening those client relationships but also in more billable hours.

And we see potential for growth in our cloud business in Europe, as clients are looking to facilitate future remote work capabilities. So mixed effects ultimately. Though there was a short-term impact on the company, I see more positives than negatives in the long-term as we are continuing to strengthen those client relationships, and more importantly proving our abilities to be an IT solutions provider in a work from home environment.

Kevin Liu. As you start to see operations return to a little bit more normalcy as countries and states start to reopen, do you have any sense from your clients at this point in terms of whether their level of engagement with you is going to return to fairly normal pre-pandemic or is it just too early to tell?

Filip Gydé. It's very early to tell and I'm definitely not going to speculate on how long and how deep this pandemic crisis is going to be. What we do see Kevin is that we continue to talk about business development, about new opportunities. So in the long-term, I'm confident that we're going to get back to a pre-COVID level as we're still working together with our clients on new opportunities. Now, the timing of that is obviously the million dollar question. In all the economic reports that I'm reading, I don't see anybody saying that this is going to really come back very fast in the next quarter or the quarter after that. Nobody is writing those kind of predictions, but that at this moment, I think it's sad to say that nobody really knows.

Kevin Liu. You also mentioned earlier that you guys did continue to add on the business development front in the first quarter here. How were you seeing your results cycle impacted, if at all, by the pandemic and then as you head into the next few quarters, are you satisfied with the level of hiring thus far? Do you plan to continue to add to the sales and marketing organization?

Filip Gydé. Well, we haven't really seen a lot of sales cycles impacted in the last quarter, in March we saw more of what I said before – start dates being pushed out. But we're working with clients on proposals, on reference checking, on activities that are very far into the sales cycle. So that is continuing. And that's also why we decided to continue to invest in sales and solutions professionals. Going forward, we're maintaining a strong pipeline of sales and solutions professionals. I think that's just a wise action for a company like ours because we can always use talent in those areas. But we'll have to see in the next coming quarters how fast we're going to act on that pipeline or how much time we're going to need to grow further. But on a long-term basis, we see that our strategy is actually helping us now and that we will definitely feel confident we'll come out stronger from this crisis and be ready when things pick up, post COVID.

Kevin Liu. In terms of some of the actions you guys took at the start of this month, furloughing non-billable folks and the like, would you talk about what sort of expected cost savings you'll see from those actions, either on a quarterly or annual basis?

John Laubacker. Good morning, Kevin. Good to hear from you. The actions that we've taken, just to reiterate, we did furlough on a full-time basis, a small number of non-billable resources. And then effectively for nearly all of the remaining non-billable resources – including the senior management team, so including Filip, myself and the rest of the executive leadership team – to a 20% furlough, effective April 6. Our goal is to evaluate that as we go through each month in each quarter to understand the impact on us, long-term. So this is not something that we put in place for a set period of time. It's something that we're really constantly evaluating almost on a daily basis as we understand what Filip just talked about from a business development standpoint. The information and the instructions we receive from our clients about the amount of activity that they need support for at this point in time.

So at the end of the day, those actions themselves really create between $0.5 million to $1 million a quarter of cost reductions, but that's for an entire quarter. And again, something we're critically evaluating as we go through this process.

Kevin Liu. How much revenue did the acquired StarDust operations contribute within the quarter and then, given the timing of the launch of testing services in the U.S. being mostly towards the latter part of the quarter, curious as to how you expect that business to ramp up in terms of pipeline and the ultimate business over the course of this year?

Filip Gydé. As with other acquisitions, StarDust is not intended to standalone, so we will not break out the revenue or financial results on an ongoing basis. However, as we said at the time of acquisition, our revenue was approximately $7 million annually and while we completed in early March. As to our testing solutions in North America, basically, even before we officially announced our testing solutions in the States, we were active with clients and active in finding out what kind of potential there was in the market. In the pipeline we have built, even before the official launch, is quite impressive and it's still continuing to grow. So we're very positive about testing. I think we have a very good focus in that Health Solutions vertical because there was a real strong need with the increasing speed of new releases for instance in EMRs like Epic. The quarterly testing is now moved to monthly and the annual testing is now moved to quarterly testing because there are more releases, and that's just a painful situation for most of our clients.

So we see a lot of potential; we see growing pipelines. Obviously, the decision moments have been pushed a little more into the future and we'll see in the coming quarters how fast we can convert this pipeline into business.

Operator. There are no further questions you may continue.

Filip Gydé. I'm proud of our organization, the resilient dedication of our team, and our numerous accomplishments over the past quarter. Regardless of the prevailing landscape, we will proactively manage those factors that are within our control while remaining committed to actively supporting our clients by delivering the value added solutions and services that CTG has been known for since 1966. I remain extremely confident in our strategy and ability to drive transformational growth in our IT Solutions business through the continued focus on disciplined execution. In doing so, we will further enhance profitability as well as maximize value for all CTG shareholders. I am very confident we will come out of this crisis strong. Thank you for participating on today's conference call and for your continued support of CTG.
