Operator. Ladies and gentlemen, thank you for standing by, and welcome to the CTG Quarterly Investor Call. As a reminder, this conference is being recorded. I'd now like to turn the conference over to Jim Culligan. Please go ahead.

Jim Culligan. Thank you, Linda, and good morning, everyone. With me on today's call are Filip Gydé, 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'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, October 22, 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'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. I am very pleased to report that we delivered another quarter of excellent results, including continued strong revenue growth and significantly higher operating income year-over-year.

Total revenue grew 7.7% in the third quarter and represented the seventh consecutive quarter of year-over-year growth. Year-to-date, revenue increased 11%, including organic revenue growth of 8.2%. Importantly, we continued to meaningfully outpace the growth rate of our target end markets.

Third quarter operating income nearly doubled year-over-year. And year-to-date operating income increased 57%, more than five times the growth rate of our revenue. As a result, adjusted EPS increased to a multiyear high for the second consecutive quarter. Collectively, these results reflect multiple progress on our strategy, as well as continued momentum on our growth and profitability initiatives. Additionally, these results demonstrate the dedication of our team and our continued focused execution of our growth strategy.

Our operating success in the quarter is the result of how the core elements and objectives of our strategy are driving strong results. We are successfully transforming CTG into more solutions-centric organization, as we continue to focus on growing our IT Solutions business at a faster rate than our Staffing services business.

Our high-margin Solutions business enabled CTG to assume more responsibility for, and management of, the delivery and outcome of the services provided. This, in turn, provides deeper client relationships and increased client loyalty while also adding value and generating increased profitability for both CTG and our clients. An expanding Solutions platform has served as the core foundation and remains the primary driver of the consistent multiyear, above market performance of CTG's European business. We are focused on positioning the broader company to replicate the resounding success of our solutions-centric model in Europe by further leveraging and expanding our existing global Solutions platform across the entire CTG organization.

In addition to our growth strategy around IT Solutions, another fundamental objective and current priority is to improve the profitability of our IT staffing business, particularly in North America. In support of this objective, we've implemented a series of structural changes over the past two quarters and further refined our approach within the Staffing business. Most importantly, we've become significantly more selective on staffing services engagements. This includes both prospective engagements for new business, as well as how we evaluate potential renewals or extensions of existing services.

Regardless of the engagement, we have remained disciplined on pricing and prioritizing higher-quality revenue opportunities. Further complementing this approach, we continue to focus our IT staffing sales organization on expanding engagements in the middle markets and increasingly target higher value professional services opportunities. This focus led to outstanding quarterly results in the business, which I will touch on in a moment.

Strategic acquisitions are also core part of our strategy. With respect to the most recent acquisition of Tech-IT in February, we are in the final phase of customary integration activities, and our team remains on track to complete those efforts by year-end.

Both Tech-IT and SOFT Company, which we acquired in early 2018, have continued to perform well, are accretive to earnings and have complemented the significant organic growth of CTG's existing business. More importantly, each of these businesses has established unique strategic opportunities to accelerate future growth through penetration of a new geography and expanded synergistic solutions-focused offerings. SOFT Company expanded CTG's geographical presence with a well-established position in a large and growing IT services market in France, while also increasing the depth of our relationships with existing core banking clients.

In Luxembourg, Tech-IT added cloud services and other capabilities that fill the gap in our Solutions portfolio, providing CTG with the ability to offer strategic end-to-end solutions to our current and prospective clients across Europe. While there is still more value to unlock, we are pleased with the synergies generated by these strategic acquisitions.

Turning to the quarter, our IT Solutions revenue increased 13.9% year-over-year and 22.6% year-to-date, providing clear evidence of our continued progress and the successful execution of our strategy. Year-to-date revenue from IT Solutions surpassed $100 million and expanded to nearly 35% of total revenue compared with approximately 31% of total revenue during the first nine months of 2018.

Growth and momentum continue to be driven by strong adoption of our core global solutions offerings — Application Advantage and EIM Advantage. CTG's Application Advantage offering includes a comprehensive series of application management and service desk solutions that apply across a broad number of market verticals with notable recent traction in the financial, healthcare and energy verticals.

EIM Advantage is comprised of data-centric solutions, including data management and data analytics, all of which are designed to provide clients with actionable information to make more informed decisions about their businesses. We have a solid pipeline of engagements for each of these global solutions, and we have remained focused on extending our capability to provide repeatable Solutions offerings in new regions and end markets. We are continuously working and investing to expand our existing Solutions portfolio with new and complementary offerings, including the incorporation of robotic process automation and artificial intelligence capabilities into CTG's global solutions.

Looking specifically at our Health Solutions business, we achieved another solid quarter of consecutive year-over-year growth, which was driven by the continued ramp of business from previous recent contract wins. During the quarter, the team secured a combination of contract extensions for our Solution offerings and expanded the scope of work at multiple prominent clouds.

Year-to-date, Health Solutions revenue grew by more than 15% compared with the same period in 2018. This growth is purely organic and a direct result of our previous investments to expand and reposition CTG's Health Solutions offerings. In addition, we are continuously evolving our portfolio of Solutions offerings to remain well aligned with current industry trends and needs of our healthcare clients, the most significant being the ongoing yet gradual adoption of value-based care.

Consistent with our strategy of making focused investments in the highest performing areas of our business, we added a new sales team member in Health Solutions during the quarter and plan to invest in the further expansion of the sales organization over the coming quarters.

In Europe, we achieved another strong quarter with reported revenue increasing 13.8% year-over-year and 19% in local currency. The growth rates and operating performance of our European operations continues to exceed that of our served markets in the region. We are consistently driving healthy organic growth from a combination of new and existing clients while also benefiting from our acquisition of Tech-IT earlier this year. During the quarter, the team secured more than a dozen new accounts, which included multiple incremental wins for Application Advantage as well as several new engagements for our regulatory compliance and testing solutions. Overall, headcount in Europe remained strong in the third quarter, and utilization was above average despite typical summer seasonality, due in part to our ongoing and successful ramp of previously won expanded contracts with European institutions.

Shifting to our IT Staffing business, during the quarter, we began to observe the early results of our previously mentioned priority of being more selective on engagements, while also emphasizing higher-quality revenue opportunities for IT and professional staffing services. Revenue increased 4.8% year-over-year and in part represented initial evidence of our refocused sales efforts to secure and ramp the growing number of new middle market clients. Also during the quarter, we were rewarded a new higher margin engagement from an existing IT staffing client for a promising hybrid multi-cloud project.

In further support of our refocused sales approach and ongoing initiatives to improve the operating performance of our Staffing business, we've reemphasized efforts with certain existing clients to convert select IT staffing services to managed services engagements. Similar to other Solutions offerings, managed services engagements involve CTG taking on more responsibility for the management of the team and delivering continuous service improvements. However, these engagements also provide us more control and ability to leverage potential automation as well as other efficiencies, resulting in potential cost savings, higher profitability and added value for both CTG and our clients. Although still in the early stages, we are having active conversations with multiple existing IT staffing clients about potential conversions to managed services engagements.

We remain highly confident in our strategy and committed to our ongoing transformation to a solutions-focused organization. I am excited about the consistent progress we've accomplished to grow our IT Solutions business and refocus our IT Staffing business, all of which is directly attributable to the team's hard work and disciplined execution.

I will now turn the call over to John for a detailed review of our third quarter financial results, as well as our outlook for the remainder of 2019.

John Laubacker. Thank you, Filip, and good morning to those joining us on today's conference call. As reported in this morning's press release, consolidated revenue in the third quarter was $97.2 million compared with $100.4 million in the second quarter of 2019, and $90.3 million in the third quarter of 2018. Currency translation had a negative $1.6 million impact on revenue in the third quarter of 2019. Billable days in the quarter were 63 compared with 64 days in the second quarter of 2019, and 63 days in the year ago third quarter.

Solutions revenue in the third quarter of 2019 increased nearly 14% year-over-year to $33 million, representing 33.9% of total revenue. Year-to-date, Solutions revenue has grown 22.6% over the first nine months of 2018 and represented 34.6% of total revenue. As Filip highlighted in his remarks, the increase in Solutions business was driven by a combination of solid organic growth within our Health Solutions business in the U.S., growth in other European operations and the contribution from our acquisition of Tech-IT earlier this year.

Staffing revenue in the third quarter was $64.2 million or 66.1% of total revenue, reflecting year-over-year growth of 4.8% compared with $61.3 million or 67.9% of total revenue in the third quarter of 2018.

Revenue from IBM in the third quarter was $21.3 million or 21.9% of total revenue, compared with $21.1 million or 21.1% of total revenue in the second quarter and $19.8 million or 22% of total revenue in last year's third quarter. No other client represented more than 10% of revenue in the third quarter of 2019 or during recent comparable periods.

Direct costs as a percentage of revenue were 80.7% in the third quarter of 2019, compared with 81.7% in the second quarter of 2019 and 80.8% of revenue in the year ago quarter.

GAAP net income in the third quarter of 2019 was $879,000, or $0.06 per diluted share, and included approximately $500,000 in acquisition-related expenses. Non-GAAP net income was $0.10 per diluted share. This compared with GAAP net income of $943,000, or $0.07 per diluted share, in the second quarter of 2019, which included approximately $400,000 in acquisition-related expenses. GAAP net income in the year ago third quarter was $1.1 million, or $0.08 per diluted share, which included approximately $500,000, or $0.04 per diluted share, in acquisition-related expenses, as well as approximately $800,000, or $0.06 per diluted share, from a non-taxable gain from life insurance proceeds, resulting in non-GAAP net income of $0.06 per diluted share in 2018.

The effective income tax rate in the third quarter 2019 was 33.5%, compared with 36.6% in the second quarter and 22% in third quarter of 2018.

CTG's total headcount at the end of third quarter was approximately 4,350, which was the same as the end of the second quarter of 2019 and compared with 4,150 at the end of the year ago third quarter. Similar to last quarter, the year-over-year increase in headcount primarily reflects a combination of the Tech-IT acquisition in February 2019, as well as our organic growth in both the U.S. and Europe. Approximately 92% of third quarter 2019 headcount was billable, consistent with our historic levels in previous quarters.

Turning to our balance sheet, cash and cash equivalents at the end of the third quarter were $10.7 million. The company's outstanding long-term debt at quarter end was $8.6 million, which is a notable reduction compared with outstanding debt of $17 million at the end of the second quarter. As previously indicated, the company's outstanding debt at the end of the prior quarter reflected the last day of the second quarter falling on a payroll date in United States.

Capital expenditures in the third quarter of 2019 were $583,000 compared with $380,000 in the second quarter of 2019 and $606,000 in the third quarter of 2018.

Our updated guidance for the full year 2019 is based upon our strong third quarter financial results and our current outlook for the remainder of the year. Consistent with our strategy to prioritize high-quality revenue opportunities within our IT Staffing business, we recently elected not to renew a portion of a lower-margin staffing business with a large client. This decision will have a measured effect in fourth quarter revenue, and therefore we have lowered the high end of our full year revenue guidance.

Specifically, we now expect full year 2019 revenue to be in the range between $390 million and $400 million. Additionally, we have raised the range of our full year guidance for both GAAP and non-GAAP diluted EPS, as we expect to realize continued benefits in the fourth quarter from a higher mix of Solutions business, more selective engagement within our Staffing business, and focused execution on operational performance. We now anticipate GAAP net income for the full year to be in the range between $0.23 and $0.29 per diluted share. Excluding acquisition-related expenses associated with our previously completed transactions, we expect non-GAAP net income for the year to be in the range between $0.33 and $0.39 per diluted share.

With that, and before we open the call for questions, I would like to remind everyone that the purpose of today's Q&A session is to discuss our financial results for the third quarter of 2019. Linda, could you please manage the question and answer session?

Operator. We will go to the line of Kevin Liu with K. Liu and Company. Please go ahead.

Kevin Liu. The first question I wanted to ask was on the Staffing business. You mentioned that you'd opted not to renew some low-margin business. Was that with your largest customer? And could you speak a little bit about how you're planning to reallocate those resources? Are you going to maintain those or are you going to reduce headcount going into the fourth quarter?

Filip Gydé. Well, as you know, consistent with our strategy to be selective with lower margin staffing opportunities, we decided not to renew a portion of business with one of our larger staffing clients. We remain focused on driving our Solutions business, and we will critically analyze our Staffing business to ensure it continues to add value to our clients, our business model and our shareholders. Where we determine that is not the case, we will not renew this type of business when the contract comes due. And concerning the staff in those assignments, we will obviously look where we can redeploy at the scales that we need to drive our Solutions business forward, and we will redeploy as many people as we can.

Kevin Liu. That's helpful. Also along those lines, obviously you have NTS Agreement with IBM that's coming up for renewal at year end, is this, kind of, related to that agreement at all? And maybe separately, just could you provide an update on the timeframe for when you think a decision will be made on whether to renew that contract?

Filip Gydé. Well, first of all, this is not at all related to the renewal of our contract with IBM. We have several conversations with IBM about other opportunities and about new opportunities, and we are, as you correctly state, in the process of discussing the renewal of the contract. As always, IBM tends to start those discussions in October and finish them in the time frame of November to December, and we have no reason to think that this time it will be different.

Kevin Liu. Great, that's helpful. Turning to your Healthcare Solutions business, you've talked about some of the potential catalysts there with some new leadership as well as the shift to value-based care. Can you just talk about what sort of demand the transition of value-based care is creating? Which of your offerings is going to resonate best in that market? And then also just more generally as you bring on new leadership and expand that sales team, what sort of ramp up period you think there will be until you start to see even more growth within the healthcare business?

Filip Gydé. Well, our health care business has been at the basis of our impressive improvement in our Solutions business, and this began with the win the win of CHI in 2018. That continued in the first quarter this year with big Application Advantage win, with a large hospital system in the Northeast, in the second quarter with multiple wins, again, in the Northeast, and in the third quarter, we successfully extended an expanded growth with existing clients. So our Healthcare Solutions business is one of the drivers of our move to Solutions. We see as the trend is to move to value-based care, we see a couple of elements of our Solutions portfolio very well positioned, like on one side, the Application Advantage offering, which is taking responsibility for applications that are already there and need to be maintained and supported so the hospital systems can really focus on moving to value-based care.

And the young one is EIM Advantage because value-based care is all about data management — data management, data analytics, data visualization. With the implementation of the new EMRs, there is a lot of data there and you really need to master that data and make it into information to be able to move to more value-based care organization.

Kevin Liu. Filip, you also mentioned some opportunities around RPA and AI within your script, I was just wondering whether CTG has some of those capabilities in-house already or can develop in-house organically, or do you anticipate going out and perhaps doing an acquisition in that area?

Filip Gydé. Well, at this moment, we're using RPA and AI to mimic the actions and decision-making process of first-line service desk agents. This way, we automate the part of the process. We shorten the working time per ticket for our agents. That way, the cost of the services decrease and we provide an added benefit to our clients. At this moment, we have begun the use of RPA and AI in the proof-of-concept stage for three different clients and are excited about its future potential and are going to remain on that route going forward.

Operator. There are no further questions.

Filip Gydé. Thank you, Linda. As we continue to transform the enterprise and increasingly position CTG as a premier global solutions provider, we expect to deliver a significant benefit to new and existing clients through an expanding portfolio of innovative Solutions offerings. The growth of our IT Solutions business will continue to serve as a fundamental driver of further profitability improvement as we realize the benefits from an increasing mix of higher-margin business.

Finally, and most importantly, we believe the continued successful execution of our current strategy will result in substantive follow-through on our commitment to deliver increased value to CTG shareholders.

As always, we appreciate you joining us on today's call and for your continued support of CTG. Linda, you may now disconnect.

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 (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 Web site (www.ctg.com) for approximately 90 days after the call date, 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.