Operator: Greetings and welcome to the Computer Task Group, Inc. First Quarter 2022 Financial Results Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Craig Mychajluk, with Investor Relations. Please proceed, sir.

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

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

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

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

Filip Gydé: Thank you, Craig, and good morning, everyone. We appreciate you joining us today. The first quarter of 2022 continues to demonstrate our success at capitalizing on the market demand for digital transformation solutions and was a strong testament to the disciplined execution of our strategy to increase the business mix of IT solutions and, ultimately, drive profit margins.

Our GAAP earnings per share grew 50%. Improving margins drove earnings power despite revenue being down from lower-margin nonstrategic technology services and foreign currency headwinds.

As a reminder, last quarter, we introduced our new financial reporting structure with three business segments. IT Solutions and Services are disclosed through North America and Europe and represent our higher-margin IT services. We are only making investments in these two segments. During the quarter, we achieved strong earnings growth even when continuing to invest in our business development solutions and delivery resources.

We also continued to disengage from the lowest-margin staffing business, which can be seen in our Non-Strategic Technology Services segment, where revenue decreased $6.2 million in the quarter compared with the prior year.

We strive to be a leader in the delivery of digital IT Solutions and Services that create opportunities for our clients to succeed despite the headwinds they may face. This includes finding more efficient ways for our clients to operate by digitizing their processes and assets.

As an example of the steady progress we are making, we won our largest digital solutions development contract in the company's history in North America during the first quarter. The contract will span five years and provides a significant foundation for us to further drive digital IT solutions in the future.

Wins like that result from our people, who are our most important asset and are critical to our success. In a tough and competitive labor environment, we have been successful in adding talent. We continue to advance our colleagues in support of our strategy as we look to strengthen our team to meet the ever-changing needs and challenges of our clients.

We recently promoted Brett Hunt to the newly-formed position of Vice President of Solutions and Delivery for North America. Brett joined CTG in July 2020 after 20 years with HP. In his new role, Brett will be responsible for executing and continuing to evolve CTG solutions and delivery strategy in North America.

I am extremely encouraged with our progress in executing our strategy despite macroeconomic headwinds. Our pipeline of organic opportunities in digital solutions continues to expand and has grown significantly over the past year. Equally important is our focus on acquisitions, where we have a well-defined process that produces a solid pipeline of opportunities.

We believe we have the financial flexibility to execute and acquire companies, but, as always, we will be prudent with our capital allocation. Our acquisition criteria are focused on businesses that provide digital expansion opportunities, have accretive margins and earnings, and look to be a good cultural fit.

As we mentioned on our last earnings call, we anticipated a soft quarter for revenue due to the timing of engagements and lower utilization from a higher rate of illness from COVID variants that impacted the beginning of 2022 on our billable resources. Based on current project timing and opportunities in the pipeline, we expect our quarterly revenue cadence to pick up in the second half of the year.

As we look further out, our objective is to grow IT Solutions and Services revenues in the mid to high single-digits organically and deliver contribution margins for these segments in the mid-teens. We expect this will enable us to achieve our goal over the next two years of adjusted EBITDA margins increasing to 7% to 8% of revenue.

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

John Laubacker: Thank you, Filip, and again, good morning, everyone. Thank you for joining us on today's call.

Consolidated revenue in the first quarter was $89.4 million, down approximately 8%, or $7.7 million, of which, $6.2 million was attributable to the planned disengagement from our Non-Strategic Technology Services business. Foreign currency also had a material and more substantial than expected unfavorable impact in the quarter totaling $3.1 million.

First-quarter revenue from North America IT Solutions and Services increased nearly 11% to $20.4 million as this segment captured new customers and opportunities in digital IT solutions, including the 5-year contract that Filip previously mentioned.

Revenue from our Europe IT Solutions and Services segment was $42.5 million, down $3.5 million, largely due to a client internalizing a project for about 20 resources during the quarter and the continued impact of unfavorable foreign currency translation. Excluding foreign currency, revenue for this segment would have declined approximately 1%. We expect the impact of the client internalizing a project to total more than EUR 1 million by the end of 2022. This change does not indicate a problem or concern with the client but rather the client's desire to internalize the resources.

As a result of the changing revenue mix, largely driven by North America, our margin profile and profitability improved measurably during the quarter. Consolidated gross profit was $20.6 million, which equaled a 23% margin. This was 160 basis points higher than last year's first quarter and 340 basis points higher than the two year-ago period.

For IT Solutions and Services, North America gross margin increased 100 basis points to 33.6%, while Europe gross margin expanded 30 basis points to 24.7%. Both segments reflect the increased mix of higher-margin IT Solutions and Services revenue. While we continue to disengage from the lowest-margin projects in Non-Strategic Technology Services, that segment has also seen a steady improvement in margins.

SG&A expense in the first quarter of 2022 was $17.4 million, or 19.5% of revenue, representing a nominal increase of 30 basis points versus the year-ago period. GAAP operating income increased 52% to $3.2 million, or an operating margin of 3.6%, up 140 basis points.

Non-GAAP operating income, which includes $262,000 of acquisition-related expenses, was $3.5 million, or 3.9% of revenue, up 110 basis points. We achieved net income of $2.2 million, or $0.15 per diluted share, in the quarter compared with $1.5 million, or $0.10 per diluted share, in the first quarter of 2021. That's a 50% increase in earnings per share year-over-year.

Non-GAAP EPS was $0.16 per diluted share compared with $0.13 in the year-ago period. In keeping with our improved margin profile, the adjusted EBITDA margin improved 100 basis points to 4.8% in the quarter.

CTG's total headcount at the end of the quarter was approximately 3,250, of which 89% was billable. This compares with 90% billable during the prior-year period.

Turning to our balance sheet and cash flow. Cash and cash equivalents were $38.7 million, up $3.1 million or approximately 9% from year-end 2021. Cash provided by operations was $4.4 million, nearly double last year's comparable period. There was no outstanding debt at quarter-end.

As we noted in the release, macroeconomic conditions in the European Union have significantly decreased the value of the euro, and we do not see this reversing in the short term. As a result, we are reducing our annual revenue guidance by $15 million, solely due to foreign currency exchange. We now expect our revenue for 2022 to range from $360 million to $380 million. This revised level still reflects the approximate $25 million to $35 million impact from the disengagement from Non-Strategic Technology Services this year.

Importantly, we remain on track to achieve our earnings growth this year as the continued transformation of the business mix, the higher-margin IT solutions, is expected to drive non-GAAP diluted earnings per share ranging from $0.64 to $0.72 per diluted share.

That completes our prepared remarks. Maria, could you please open the call for questions?

Operator: [Operator Instructions] Our first question comes from Kevin Liu with K. Liu & Company LLC.

Kevin Liu: Nice job on the margins. I wanted to touch on Europe. First, you mentioned the client that's internalizing some resources there. Can you talk about whether the full impact of the EUR 1 million was recorded within the first quarter or if that's spread out over the course of the year?

And then, maybe more generally, it seems like most of the revenue guidance is just purely due to FX. Could you speak to the broader demand environment you're seeing in Europe, given some of the macro noise out there and whether you expect to maybe return to growth on a constant currency basis later this year? That would be helpful.

John Laubacker: Sure. Kevin, I'll address the financial pieces, and Filip, if you want to talk about the macro environment, that would be great. The internalization of the projects that we had were clients who just decided to internalize those resources, we expect that to be EUR 1 million throughout the year. So, that was not all in the first quarter, but it started in Q1 and then will distribute evenly, we think, throughout the rest of the year. So, that EUR 1 million reflects the entire year, certainly not just in the first quarter.

Relative to growth overall and just the numbers themselves, as you know, part of our plan has been to strategically disengage from the lowest-margin staffing projects over the past couple of years. So, we have $25 million to $35 million, we think, within our guidance as far as revenue that will come out of the process from where it has been last year. That number, Kevin, has been $20 million to $30 million over the past two years, and that's sort of what guides us to say $25 million to $35 million overall for this year.

Kevin Liu: Actually, I was focusing more so on the Europe piece. It doesn't sound like you see too much going on from just a macro standpoint. It seems like it's all FX. So, maybe if we look on a constant currency basis or an operating basis, are you expecting to be able to return the European business to growth in the back half of the year, or is there any concern that the macro hinders demand for those services there?

Filip Gydé: Well, regarding the macroeconomic headwinds and, of course, the Russia-Ukraine conflict, we have not experienced any significant impact. We don't have any delivery centers in Ukraine. That has been a popular place for nearshore delivery centers in Europe, but we were not affected by that.

We do see some headwinds as a result of two things: first, the high inflation; the cost of energy, to name one, but the inflation is on everything. It is on labor, too, and the uncertainty associated with the conflict, but, at this moment, Kevin, I can only say that our pipeline is solid. When we say that we see our revenue cadence picking up in the second half of the year, that's definitely true for Europe too. Those are our expectations.

Kevin Liu: That's great to hear. And then, I wanted to touch on the big win you talked about for North America. Can you give anything in terms of the size, perhaps on an annual basis, that you'd expect, how much you got here in the first quarter and whether you see similar opportunities in the North America pipeline?

Filip Gydé: Our view alluding to the largest win we have had in North America or more generally?

Kevin Liu: The largest one you talked about or announced on the call.

Filip Gydé: Well, this is a very nice win, and it offers a lot of perspective. It's a digital application development modernization. It's using DevOps and Agile principles, so it's at the core of the client's business. It's in the manufacturing industry, and it's really about transforming the way this client ships its products to their clients.

We have had this client for a number of years, but this is now about modernizing the technology, transforming the business processes, and expanding the scope of services we were used to delivering to the client. We will also utilize this project to expand and drive our offshore capabilities in digital solutions and definitely use the knowledge and experience we gain here to sell and deliver similar services to other clients. So, it’s a very important win in our transformation into a digital solutions company.

Kevin Liu: Is this typical of the deals you're seeing in the pipeline today as well? Could you talk about the overall size of that and your confidence level in converting those to deals over the course of the year?

Filip Gydé: We see a lot of digital transformation items in almost all of the areas of focus in our pipeline. Agile and DevSecOps is definitely the area with a lot of traction, but the same is true for intelligent automation. You can't think of digital transformation without cloud computing, and when you say DevSecOps and development modernization, we are also talking about automated testing. So, we see good solid opportunities in all those parts of the pipeline.

And yes, we see our pipeline as healthy and significantly improved from just a year ago. Last quarter, I told you that we saw the throughput moving up, increasing in speed; and now, we see the pipeline increasing in the longer term, so that's why we're optimistic about the second half of the year.

Kevin Liu: That's great. Good luck as you move through the year.

Operator: [Operator Instructions] Our next question comes from Marc Riddick with Sidoti & Company.

Marc Riddick: I want to follow up on that. With what you're seeing in the pipeline, can you talk about what that looks like for your visibility into what you're seeing now versus maybe a year or two ago?

Filip Gydé: Well, normally, Marc, in any given year, we have a very high percentage of repeat business. Normally, 80% of our business is repeated in the next year. That's not all on a contract basis. That's just on loyalty and the testament to the good work our people are delivering with our clients, so our visibility into the business going forward is always solid because of that retainability.

Looking at the pipeline, like I said, we see a little bit of a headwind in Europe because of the uncertainty of the conflict and the inflation, but it's growing. I can only say it's a lot bigger than it was last year, which increases our revenue visibility for the remainder of the year.

Marc Riddick: Excellent. And then, I wanted to shift gears to the revenue mix by vertical and put aside the new contract win in manufacturing for a moment. I was wondering if you're seeing other shifts in activity with any verticals that are maybe being a little more aggressive than others at this point.

Filip Gydé: I wouldn't say so, Marc. The beauty of digital transformation is that it's valid for all industries. It's solid for industries; it's solid for the government. We have a strong focus on health care, energy, government, and European government, specifically in financial services. That now, together with this major win in manufacturing, is giving us a good spread over the four or five very important industries, and I couldn't say that there is one specifically hotter than the other at this moment.

Marc Riddick: Okay. Great. And then shifting gears to the potential for hiring and adding headcount. What should we be thinking about for the remainder of the year and potential target areas?

Filip Gydé: Obviously, we're focusing on hiring talent in the digital space. We're focusing on experts but also on solution architects. Solution architects are the people who are helping our clients to design their new processes, their new ways of liking manufacturing and shipping the goods to the clients, so that is definitely a focus. We know that the war for talent is only getting harder. That's just the fact.

Looking at our position, I think we are very well positioned. We have "Great Places to Work" certification in every location where we work, which is a huge recruitment factor in two ways. It attracts new people, because they like to work for a company that's striving to be a great place to work, but also, our own staff is referring a lot of their friends and colleagues to us. Those are just the best hires you can find, because you know the people are coming for the culture. You know they're being supported by somebody who's already there, and we see that the retention of those people is just so much higher than average.

Besides that, we're focusing very hard on growing our own talent with junior classes, so we're hiring people fresh out of school and putting them through our CTG economy, which could be in testing, DevOps or robotic process automation. It's a different curriculum that we have there. Obviously, we’re also looking at our global delivery network, where we're growing our presence in both India and Colombia, and, not to forget, our crowd testing capability that we have acquired through the acquisition in 2020 of StarDust. That is adding a network of more than 3,000 testers worldwide. So, it's not easy. It's very competitive, but I think we're in a good position.

Marc Riddick: Great. And then, last one for me. I know that the revenue mix is improved to boost margins, which is certainly moving in the right direction for the strategy. Could you talk about what you're seeing with discretionary expenses? Are you beginning to see more travel, or do you need it to generate business? Has that begun to happen or not yet?

Filip Gydé: Luckily, we see travel is happening a little bit again. It's still very limited, but we know that to be effective in the sales process, there is nothing that replaces an in-person meeting with the clients. We also see that clients are still hesitant or maybe looking at adopting a new model for that. So it's not happening as frequently as it happened before, and I don't think it will come back entirely.

On the other side, looking at our own internal traveling to collaborate, we have some of that, but with all the tools and the whole digital revolution that our own sector went through, we are very aware of the loss of time and the expenses that come with traveling, so we use that very wisely.

I think, Marc, that's definitely not even going to come back to half of what it was before. I don't see that happening. We're going to hybrid, and there are different solutions for many of the meetings now.

Operator: Our next question comes from George Melas with MKH Management Company.

George Melas-Kyriazi: About your go-to-market strategy, with the greater clarity about your strategy focusing on IT solutions, are you going to market somewhat differently versus, let's say, a year ago or two years ago? Are you targeting larger projects, more complex projects, or new verticals? Is there some change, or has it just been very more or less the same?

Filip Gydé: That's a very good question, George. Thank you for that. I would say, in general, that we're not going for necessarily more complex projects in the technology sphere. Obviously, it's different technology now than it was a couple of years ago, but we're now going more into projects that start at the business level, and I'm going to take the same example of that large win. We need to totally transform the way we ship our goods to our customers and how we do that.

So, we start to concentrate on the more business objective level than before, where we were staying more in the technology and the realization only. That being said, it also means that we are sticking to the industries where we are very strong. To do that, you have to know the business knowledge and speak the client’s language. That's why having loyal clients in those four or five industries where we are strong makes a difference. They know we don't only speak the language of their sector; we speak *their* language and understand them because we have been with them for a long time.

George Melas-Kyriazi: Does that imply a certain training of your salespeople to talk more to business people as opposed to tech people? What are the challenges to transforming and making a shift like this?

Filip Gydé: I would say, the focus that we are putting is that it's no longer, and it hasn't been for a while now, a story of sales selling a project. It's sales together with solution architects, sometimes multiple solution architects, working together with the client in the future designing the project. So, yes, our sales are talking more with business people than before, but that wasn't a major change. They were doing that already, but now, with those solution architects and the experts we're bringing in, it's more like a 4-legged sales call or 6-legged sales call. It involves more people in the sales process.

George Melas-Kyriazi: Okay. Great. And then, just finally on that, does that mean that a lot of these projects are not bid out by the customer that you involved in the design and then you do the execution or are you involved in the design and then there is still an RFP that you have to bid on?

Filip Gydé: It's a combination, George. I wouldn't say that I see a difference or a shift in moving to more or less RFP clients. We always want them to have a second or a third opinion or other companies to compare with. If you're designing the future together, you're in what we call column A; and then the others coming later in the game don't have all the information, so it improves our chances of winning.

Operator: We have reached the end of our question-and-answer session. I would now like to turn the call back over to management for closing remarks.

Filip Gydé: Thank you, Maria. Thank you for participating in our teleconference today.

The first quarter was another demonstration of continued progress and execution of our digital solution strategy, and we believe the journey has just begun. We certainly appreciate your continued interest and support. Please feel free to reach out to us at any time, and we look forward to talking with all of you again when we report our second quarter 2022 results.

We hope you have a great day. Maria, you may now disconnect the call.

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