Operator: Ladies and gentlemen, thank you for standing by, and welcome to the CTG Quarterly Investor Call. (Operator Instructions) And as a reminder, we are recording today. I would now like to turn the conference over to Jim Culligan, CTG's Director of Investor Relations. Please go ahead.

Jim Culligan. Thank you, Art, 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 mention that statements during the course of this conference call that state the Company's or management's intentions, hopes, beliefs, expectations and predictions for the future are forward-looking statements. It's important to note that the Company's actual results could differ materially from those projected. These forward-looking statements are based on information as of today, Thursday, April 18, 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 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 Filip for his opening remarks.

Filip Gydé. Thank you, Jim. Good morning to everyone joining us on the phone and webcast. It is my pleasure to host today’s call.

Let me begin with where I’ve been focused and my initial observations since assuming the role of CEO on March 1st. I’ve been actively meeting with our various teams and numerous employees across the organization, and I could not be more pleased and encouraged by the shared energy and optimism that I have observed. Throughout the quarter, I’ve also been proactively engaging with a large number of CTG clients and partners, and the feedback has been extremely positive. Collectively, these interactions have further reinforced my excitement and confidence in the opportunity to build upon our recent momentum and increasingly position CTG as a premier global solutions provider.

To reiterate, CTG’s core strategic objectives continue to be to grow Solutions revenue at a higher rate than Staffing revenue; to expand our Solutions offerings, while continuing to secure growing engagements for our existing Application Advantage and Enterprise Information Management, or EIM, Advantage solutions; and to improve our mix of business in North America, specifically within Staffing, by broadening existing client relationships to include higher value Solutions business, more selectively pursuing IT and professional staffing services, and targeting higher margin opportunities at new middle market accounts.

These strategic objectives remain consistent with our company-wide goals of enhancing the quality of revenue, providing the highest level of service to our clients, increasing the overall profitability of our business, and duplicating the track record of success we’ve demonstrated within our European operations across the entire organization. Although I don’t currently foresee making major shifts to our objectives and initiatives, I look forward to sharing anticipated refinements to our strategy in coming quarters.

Turning to a high-level update on the business, similar to what we previously experienced during the early stages of investment in our European business, our consolidated top-line growth is expanding in advance of the increase in our bottom-line results. Nevertheless, we believe our Q1 results are on track with consolidated revenue growing 18% year-over-year, and we are making progress toward driving profitability. Importantly, our prior and ongoing investments have established a solid foundation for improved earnings as we continue to convert our growing pipeline of engagement opportunities into new project and contract wins. Coupled with our focus on disciplined execution and realizing greater cost efficiencies, we anticipate incremental improvement in our operating results throughout 2019.

Central to our goal of driving both sustainable and profitable growth is the increased emphasis on our Solutions business, from which revenue grew 34% year-over-year in the first quarter. As we continue to expand our Solutions business and offerings, we expect the more favorable revenue mix to be a key contributor to improving CTG's future bottom-line results. In addition to having a more favorable margin profile, solutions offerings represent higher-value services with the opportunity for deeper client engagements and increased client loyalty. We continue to gain momentum with our expanding portfolio of solutions offerings across a range of sectors, including healthcare, energy and financial institutions. Our core global service offerings are comprised of Application Advantage – and EIM Advantage.

CTG's Application Advantage solution helps clients maximize the value of their enterprise applications through a suite of integrated assessment and roadmap, application management, and help desk services. These services help clients meet their rapidly escalating business and technology needs while reducing costs, creating scalable workforce capacity, and improving process efficiencies~~.~~ We continued to secure a growing number of engagements during the first quarter, including a win with a major healthcare system in the northeastern U.S., and our pipeline for Application Advantage is currently at an all-time high.

Our EIM Advantage offering consolidates several existing services into a single comprehensive solution that addresses clients' needs to capture, manage, analyze and transform the ever-increasing volumes of data into actionable information. Although this leading-edge solution is relevant across a diverse range of industries and applications, we've recently seen notable traction within the Energy market vertical with existing oil and gas clients. Over time, we expect EIM Advantage to benefit from the growing need for a more robust data management framework across other industries, including healthcare as providers who now have a significant amount of digitized data resulting from electronic health records implementations gradually transition from the traditional fee-for-services model to value-based care.

Specific to our Health Solutions business, we secured several significant new clients in the first quarter, as well as a combination of new contracts with existing customers and multiple other contract extensions and renewals. I'm confident our strong Health Solutions leadership team will enable CTG to capitalize on the healthcare industry's digital transformation, and growing need for IT services related to population health and optimizing EHRs for value-based care.

Turning to our European operations, our solid performance is a product of our team's ongoing commitment to operational excellence, continued organic growth, and the contributions from our 2018 acquisition of Soft Company and our February 2019 acquisition of Tech-IT. We recently collaborated with the Tech-IT team on several RFP's for new business, and we already have CTG employees actively deployed at inherited Tech-IT clients. Moreover, the post-acquisition interaction between CTG and Tech-IT resulted in recent wins on several contracts that neither stand-alone company would otherwise have been awarded. We are very pleased with the initial synergies resulting from the Tech-IT acquisition, and look forward to continued success.

In addition to contributing to our top-line growth, these strategic acquisitions expanded our European footprint, deepened our penetration of existing markets, and broadened our market leading presence in other market verticals, including banking, financials and other European institutions.

Shifting to Strategic Staffing, our engagement pipeline increased during the first quarter, and we recently secured two notable, nationwide contracts. In addition, we expanded our services to new divisions of several existing clients – including our largest staffing client.

As part of continuing to evaluate our North American Staffing business to improve operating performance, we've consolidated functions into regional teams led by regional managing directors. We are also being increasingly more selective in the business opportunities we pursue to improve revenue quality and generate higher margin business.

Finally, I am very pleased with our announced appointment of Tom Niehaus as Executive Vice President – North American Operations earlier this week. Tom is a true sales leader and has a distinguished track record of building high-performing organizations by assembling and managing results-driven operations and sales teams. He will lead all CTG's sales, delivery and recruiting efforts in North America, and his initial focus will be on improving the execution within our staffing business.

With that, I will turn it over to John for a detailed review of our first quarter financials.

John Laubacker. Thank you, Filip. 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 first quarter was $97.2 million compared with $93.1 million in the fourth quarter of 2018 and $82.7 million in the first quarter of 2018. Currency translation had a negative $3.1 million impact on revenue in the first quarter. Billable days in the first quarter were 63 compared with 64 days in both the fourth quarter of 2018 and the year ago first quarter.

Solutions revenue in the first quarter of 2019 was $33.4 million, which was an increase of 14% compared with $29.3 million in the fourth quarter of 2018. Year-over-year, Solutions revenue increased 34%, reflecting continued strength and momentum in our European and healthcare operations and contributions from our acquisitions in France and Luxembourg.

Staffing revenue in the first quarter was $63.8 million, the same as $63.8 million in the fourth quarter of 2018. Staffing revenue did increase 10.5% year-over-year, driven primarily by incremental new business at large existing clients as well as a contribution from the previously mentioned acquisitions.

Revenue from IBM in the first quarter was $21 million or 21.6% of total revenue compared with $20.1 million or 21.5% of total revenue in the fourth quarter of 2018 and $18.9 million or 22.8% of total revenue in last year's first quarter. No other client represented more than 10% of revenue during the first quarter of 2019.

Direct costs as a percentage of revenue were 81.8% in the first quarter of 2019 compared with 81% in the fourth quarter of 2018 and 80.9% of revenue in the year ago quarter. The Company's direct costs as a percent of revenue increased in the 2019 first quarter as compared with the 2018 first quarter, primarily due to lower utilization of billable resources in our energy vertical market and in certain areas of our European operations where utilization by comparison was very high in last year's first quarter.

GAAP net income in the first quarter of 2019 was $632,000 or $0.05 per diluted share and included $0.4 million in acquisition-related expenses. Non-GAAP net income was $0.06 per share. GAAP net loss in the fourth quarter of 2018 was $5.3 million or $0.39 per share, which included $0.06 per share in acquisition-related and severance expenses and $0.36 per share in tax-related items. GAAP net income in the year ago quarter was $414,000 or $0.03 per diluted share, which included $0.03 per share in acquisition-related expenses.

The effective income tax rate in the first quarter of 2019 was 33.3% compared with 449% in the fourth quarter of 2018 and 21.7% in the year ago quarter. The effective tax rate for the fourth quarter of 2018 reflected a reserve for U.S. deferred tax assets, costs related to the GILTI provisions of the 2017 Tax Act and nondeductible acquisition-related costs in CTG's foreign operations.

CTG's total headcount at the end of the first quarter was approximately 4,350 compared with 4,150 at the end of the fourth quarter of 2018 and 3,650 at the end of the year-ago first quarter. The year-over-year increase in headcount reflects a combination of the Tech-IT acquisition in February 2019, organic growth in Europe and expansion of staffing services provided to our largest client, primarily in last year's second quarter. Approximately 91% of our first quarter 2019 headcount was billable.

Turning to our balance sheet, cash and cash equivalents at the end of the first quarter were $13.1 million and we had $13.3 million of outstanding long-term debt.

Capital expenditures in the first quarter of 2019 were $111,000 compared with $371,000 in the fourth quarter of 2018. In addition, we used $8.5 million, net of the cash acquired, for the purchase of Tech-IT in February 2019.

We also adopted, as required, the new leasing accounting standard that requires leases to be recorded on our balance sheet. As part of that adoption, we recorded approximately $12.7 million of leased assets and the offsetting lease liabilities on our balance sheet as of the end of the 2019 first quarter.

Turning to our guidance, as announced last quarter, beginning in 2019, the Company will only provide annual guidance. As such and based upon the momentum we observed during the quarter, we are reaffirming our previous guidance for the full year 2019. This includes our continued expectation for revenue to range from $380 million to $410 million and for GAAP net income to range from $0.20 to $0.30 per diluted share.

Excluding certain anticipated acquisition-related expenses associated with our previously completed transactions, non-GAAP net income for the full year is anticipated to range from $0.30 to $0.40 per diluted share.

As outlined on today's call, we are highly focused on driving profitable and sustainable growth. We are pleased with the positive momentum generated across the business during the first quarter. We are also committed to making investments to grow our solutions business and remaining selective in our pursuit of new prospective staffing engagements. As we increase our emphasis on CTG's solutions business going forward, we are confident that we will achieve meaningful improvement in our operating results throughout 2019. Moreover, we are also continuing to actively evaluate refinements to our overall strategy in order to further accelerate our anticipated top and bottom line growth.

Operator. We have a question from Vince Colicchio with Barrington Research.

Vince Colicchio. Filip, per your focus on increasing staffing margins going forward, I'm wondering if there are any changes to incentive compensation at the sales level and the management level to stimulate that?

Filip Gydé. Vince, I believe that our compensation policies have been and continue to be in the right direction. We have been focusing our sales and management on increased profitability and that is already giving us some meaningful progress.

Vince Colicchio. I'm curious about the new wins in the quarter for Application Advantage and for EIM. Were those margins in line with what you've seen in recent quarters for those services?

Filip Gydé. Yes, those margins are exactly in line with what we've seen and also with what we want to have for those kind of projects.

Vince Colicchio. How should we model the quarters, going forward? It sounds like incremental improvement as we go sequentially, is that right?

Filip Gydé. Well, we are well positioned, Vince, in the different businesses we are in. And we see, broadly speaking, that our profitability and the returns on our investments should come to us in sequence as we go through 2019.

John Laubacker. I'd like to add to that, that we would expect normal seasonality in Q3 that we have seen in the past not just from our European operations, but our staffing operation in the U.S. There is traditionally a larger amount of holiday time that happens during Q3. Last year, we saw a little bit bigger impact than we had in the past of actual reduction in revenue in Q3. Given the time that was taken off, I would anticipate a similar trend this year. Europe is a bigger part of our overall business, so that's really part of what we're thinking.

Vince Colicchio. In the Application Advantage service in healthcare, it's my understanding that it involves managing legacy software. With the growth of cloud, correct me if I'm wrong, is that a growing business? Or what does the growth look like for that market?

Filip Gydé. Well, with the growth of cloud, we are positioning ourselves to also be able to offer cloud services and moving our clients to the cloud—to mixed cloud, or hybrid cloud situations. So in that transition, of course, managing the legacy application is a big part. So when we take over legacy applications, take over the maintenance, the management of that, that enables our clients to focus on their cloud initiatives, and on their new application initiatives. So that's how we're helping our clients focus on their core initiatives.

Vince Colicchio. You had mentioned that there's a lot of opportunity to help healthcare organizations manage data better with your EIM offering. Is there a good pipeline for those opportunities today? How does that look?

Filip Gydé. There's a growing pipeline, Vince, because we see that a number of the providers are still a little bit hesitant to move to value-based care, but it is a trend that is increasing. And we expect in the near future that those providers will direct their spending to value-based care.

Operator. Next we have on the line of Zach Cummins of B. Riley FBR.

Zach Cummins. Can you talk a little bit more around the gross margin during the quarter? A little bit was mentioned on some of the lower utilization rates, but can you talk about some of the drivers of the lower gross margin? And can we expect that to normalize here in the next couple of quarters?

John Laubacker. I would expect that to normalize a little bit in the coming quarters. We had, really, very high utilization throughout our European operations in the first quarter of 2018, much higher than I think we would traditionally see at that point in time. And so when we saw utilization that was a little bit lower this year in the first quarter, it wasn't necessarily that it was real negative, or poor. it just was that the comparison was something that was much lower. In the energy business, we simply had a couple of our more significant clients take a break or a pause at the start of 2019. We had some ongoing projects, and some new projects scheduled, and those projects were slow to ramp up, so instead of ramping up in early January, they ramped up in late February or in early March. And so there was a bit of a pause at the beginning of the year.

Zach Cummins. That's helpful. And then in terms of the Staffing business, where you're looking for higher quality type of revenue to pursue, can you talk about some of the staffing engagements that you're actually turning away or no longer pursuing in order to improve the mix within that business?

Filip Gydé. Well, Zach, we're focusing on staffing engagements that are more in professional staffing where we see that they are also more aligned with the type of solutions we offer to the market, so we can strengthen the Staffing from our Solutions and the other way around. And frankly, just focusing on being more selective on the higher value and higher margins staffing business. So we're not going for simply volume or scale. We're going for margin and, yes, just being more selective.

Zach Cummins. I know it's probably hard to really speculate on this, but just given that Europe's becoming an increasingly bigger proportion of your business, can you talk about Brexit? While there hasn't been any final resolution, can you talk about some of the potential fallout or impacts to your European operations when this all becomes finalized?

Filip Gydé. That's a good way of putting the question—'When this all gets finalized'—because it's been kind of almost a soap story. But seriously, our business in the U.K. is relatively small, so any impact in Britain would be relatively minor, but we are continuing to assess the potential impact on Western Europe and especially Belgium because Belgium is a significant trading partner with the U.K. We're vigilant, but at this moment it's impossible to say where this is going to go.

Operator. Next we have the line of Kelly Pan with Pantheon Capital.

Kelly Pan. I wanted to know how much of the growth is organic? And I wanted to also know if you could disclose how much of the revenue during the quarter was from Soft Company and from Tech-IT?

John Laubacker. We haven't disclosed specific numbers for the revenue from the acquisitions that we've done. Last year, when we acquired Soft Company we had estimated at that point in time that revenue was about $30 million annually. Filip and I are very pleased with the progress they have made, and our estimations at that time had been pretty consistent that how we thought they would join the Company and go along. Tech-IT was closer to a $20 million U.S. annual run rate. And again, I think our expectations in Q1 were met there. So while we don't disclose specifics, we're pretty comfortable that the original estimations are holding reasonably accurately. As far as organic growth, there was very nice organic growth in the U.S. We have not done an acquisition there. That percentage itself was about

10%. Again, we don't necessarily disclose directly what the organic growth would be in Europe, but even considering the two acquisitions, they had double-digit organic growth as well in Q1, year-over-year.

Kelly Pan. So if I take that year's 2018 revenue of $358.8 million, I should subtract $30 million from it to get what organic growth was relative to 2017 of $301 million?

John Laubacker. Soft Company came on February 15, so middle of February of 2018, so it's not quite a full year.

Kelly Pan. But I'm in the ballpark if I just take that percentage down a bit?

John Laubacker. Yes.

Kelly Pan. So it looks like about 6% or 7% organic growth?

John M. Laubacker. I actually think it's a little bit higher than that, higher single digits.

Operator. We have a follow-up from Vincent Colicchio with Barrington Research.

Vince Colicchio. John, just some basic questions for you or Filip. The Solutions and Staffing pipelines, did they grow sequentially?

Filip Gydé. Well, our pipelines are growing in all areas. That's the good part or the good side of the story. In Solutions, with the acquisition of Tech-IT, we see that our broadening service portfolio is giving us, well, a tremendous increase in our pipeline there. Now we're able to deliver end-to-end solutions to our clients not only in Luxembourg, but also in Belgium and in France. And in our Health Solutions business, we also see a lot of traction and growth like we saw at the end of the year. So I think our investments in those areas are starting to show meaningful returns.

Vince Colicchio. John, just some housekeeping. You mentioned capital spending. What was the capital spending including capitalized software development? Was there any of that type of investment?

John Laubacker. There was very little capitalized software. It was only $111,000 in the first quarter in total capital. There's no pattern to that. It just was a very modest quarter as far as capital equipment expenditures.

Operator. Speakers, please go ahead with any closing remarks.

Filip Gydé. Thank you, operator. In closing, I want to reiterate my confidence in CTG's dedicated team and the foundation we have in place to drive both sustainable and profitable growth. I'm also encouraged by the progress and positive momentum we have generated in the recent quarters. Going forward, we remain highly committed to disciplined execution of our strategy, which I will continue to closely evaluate and refine over the coming quarters.

In support of accelerating the transformation of CTG into a more solutions-centric company, the entire team is actively focused on growing solutions revenue, expanding our solutions offerings and leveraging the synergies from our acquisitions in Europe. I'm excited to be leading our highly capable teams as we work together to pursue the next level of growth and realize CTG's full potential. Thank you, again, for joining today's call and for your support of CTG. We look forward to reporting our continued progress next quarter.

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.