

COMPUTER TASK GROUP INC
Form 10-K
March 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934

For the Transition period from _____ to _____

Commission File No. 1-9410

COMPUTER TASK GROUP, INCORPORATED

(Exact name of registrant as specified in its charter)

New York	16-0912632
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
800 Delaware Avenue, Buffalo, New York	14209
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (716) 882-8000

Securities registered pursuant to Section 12(b) of the Act:

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Title of each class	Name of each exchange on which registered
Common Stock, \$.01 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "an emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer	Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company) Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES NO

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates, computed by reference to the price at which the common equity was last sold on the last business day of the registrant's most recently completed second quarter was \$83.5 million. Solely for the purposes of this calculation, all persons who are or may be executive officers or directors of the registrant have been deemed to be affiliates.

The total number of shares of Common Stock of the Registrant outstanding at March 2, 2018 was 15,290,131.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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phases for planning, developing, implementing, managing, and ultimately maintaining the IT solution. A typical client is an organization with large, complex information and data processing requirements. The Company's IT solutions and IT and other staffing services are further described as follows:

IT Solutions: CTG's IT solutions typically include engagements with a fixed duration and deliverables that achieve value-based outcomes by applying the right IT solutions to address clients' business needs. These solutions include the implementation and optimization of packaged software applications, the development and deployment of customized software and solutions designed to fit the needs of a specific client or market, and the design and distribution of complex technology components. Additionally, IT Solutions services often include consulting services provided to clients at higher billable rates.

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IT and Other Staffing: CTG’s staffing services address a range of IT and business resource needs, from filling specific talent gaps to managing high-volume staffing programs. CTG recruits, retains, and manages IT and other talent for its clients, which are primarily large technology service providers and other companies with multiple locations and a significant need for high-volume external IT, administrative, or other resources.

IT solutions and IT staffing and other revenue as a percentage of consolidated revenue for the three years ended December 31, 2017, 2016, and 2015 is as follows:

	2017	2016	2015
IT solutions	30 %	29 %	33 %
IT and other staffing	70 %	71 %	67 %
Total	100 %	100 %	100 %

Capabilities

CTG provides a full range of offerings spanning seven service areas that, collectively, address many of our clients’ most pressing technology and business challenges. CTG’s capabilities ensure that our clients are utilizing the right information technology to meet their business needs, maximizing the value from their IT systems, and operating in the most efficient and effective manner.

CTG’s flexible offerings are delivered as an IT solution or IT and other staffing service, or as a strategy or service offering, allowing CTG to meet the unique needs of each client. All offerings are supported with proven program and project management processes and tools that ensure the reliability, transparency, and accountability that CTG clients have come to expect.

CTG provides capabilities in the following service areas:

- **Advisory and Planning:** Supports our clients’ needs to evaluate, select, and design new technology, align technology and business strategy, and optimize technology for improved performance and benefits realization.
- **Application Services:** Provides clients with a full range of technical support to maximize the value of enterprise software, with services that include development, deployment, integration, optimization, and application management and support.
- **Quality Assurance and Testing:** Ensures new and legacy technologies are rigorously verified to meet business requirements and industry standards. CTG delivers full testing programs for clients or can help clients assess, develop, improve, implement, and automate their own programs, as well as provide testing training and certification.
- **IT Services Management (ITSM):** Ensures the right processes, people, and technology are in place to support business goals. Offerings support our clients’ needs to deliver IT services in a more effective and efficient manner and future-proof IT to deal with changing business dynamics and threats with services including help/service desk, ITSM process improvement, technology and infrastructure implementation, disaster recovery and business continuity, and IT infrastructure outsourcing.
- **Information Management:** Helps our clients manage and derive greater value and competitive advantage from data with services that include business intelligence and analytics, enterprise data warehouses, data governance, disclosure management, master data management, and legacy data archiving.
- **Regulatory Compliance:** Assists our clients in understanding, preparing for, managing, and mitigating risk related to government regulations and industry standards. Offerings include audits and assessments, validation, and program management for highly regulated industries such as healthcare and financial services, as well as cross-industry data privacy and security requirements.
- **Strategic Staffing:** Addresses our clients’ needs ranging from staff augmentation and volume staffing to fill specific technical skills gaps, to fully managed solutions to improve recruiting quality, speed, and cost. CTG also provides

comprehensive vendor management and preferred-supplier solutions to help clients achieve significant improvements in managing contractors and technical-support processes.

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Vertical Markets

The Company promotes a majority of its services through five vertical market focus areas: technology service providers, manufacturing, healthcare (which includes services provided to healthcare providers, health insurers (payers), and life sciences companies), financial services, and energy. The remainder of CTG's revenue is derived from general markets.

CTG's revenue by vertical market as a percentage of consolidated revenue for the three years ended December 31, 2017, 2016, and 2015 is as follows:

	2017	2016	2015
Technology service providers	33.1 %	35.2 %	31.1 %
Manufacturing	24.3 %	24.2 %	25.7 %
Healthcare	16.8 %	18.2 %	23.5 %
Financial services	9.1 %	7.8 %	7.2 %
Energy	5.0 %	5.3 %	5.4 %
General markets	11.7 %	9.3 %	7.1 %
Total	100.0%	100.0%	100.0%

Revenue for the Company's technology service providers vertical market as a percentage of consolidated revenue decreased in 2017 as compared with 2016 due to a decrease in demand from several of the Company's largest clients in its IT and other staffing services business, which are included in this vertical market. Revenue from IBM, our largest client, which is included in this vertical market, decreased in 2017 as compared with 2016. The revenue as a percentage of consolidated revenue increased for 2016 as compared with 2015 due to a change in business mix. Demand from this vertical market began to slow in the 2016 fourth quarter as several large clients cut back on their requirements for our services due to their own challenging financial results.

The revenue in our manufacturing vertical market is primarily generated from several large staffing clients, including Lenovo (through SDI as a vendor manager for Lenovo) which is our second largest client. Revenue from Lenovo decreased slightly in 2017 as compared with 2016. A reduction in revenue in other vertical markets reduced the impact of these losses as a percentage of total revenue. Revenue from Lenovo decreased by approximately \$9.5 million in 2016 as compared with 2015 primarily due to a reduction in requirements from this client.

In 2015, 2016 and 2017, the demand from our healthcare clients decreased. This decrease was a continuation of a reduction related to prior years, and directly related to the U.S. federal government sequestration which cut Medicare reimbursements to hospitals and health systems by 2% starting in April 2013. As a result, the Company's healthcare revenue, primarily from electronic health records (EHR) and related projects, declined in 2014, and has continued to decrease since that time. The Company continues to transform its business from selling primarily EHR projects to advisory and technical services, outsourcing, and staff augmentation.

Revenue for the Company's financial services vertical market as a percentage of consolidated revenue increased in 2017 as compared with 2016 due to a change in business mix. Revenue in this vertical market increased in 2017, while in 2016, revenue from a number of the other vertical markets had larger reductions during this time period which caused the percentage of total revenue for this vertical market to increase.

Revenue for the Company's energy vertical market decreased as a percentage of consolidated revenue in 2017 as compared with 2016, and in 2016 as compared with 2015, as demand in this vertical market declined. Generally, the decrease in the price of oil caused several of our clients to reduce their overall spending, including requirements for IT

services, in each of 2017, 2016 and 2015.

For the year ended December 31, 2017, CTG provided its services to 463 clients in North America and Europe. In North America, the Company operates in the United States and Canada, with greater than 99% of 2017 North American revenue generated in the United States. In Europe, the Company operates in Belgium, Luxembourg, and the United Kingdom. Of total 2017 consolidated revenue of \$301.2 million, approximately 73% was generated in North America and 27% in Europe. Two clients, IBM and Lenovo (through SDI as a vendor manager), each accounted for greater than 10% of CTG's consolidated revenue in 2017.

Revenue Recognition and Backlog

The Company recognizes revenue when persuasive evidence of an arrangement exists, when the services have been rendered, when the price is determinable, and when collectibility of the amounts due is reasonably assured. For

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time-and-material contracts, revenue is recognized as hours are incurred and costs are expended. For contracts with progress billing schedules, primarily monthly, revenue is recognized as services are rendered to the client. Revenue for fixed-price contracts is recognized per the proportional method of accounting using an input-based approach. On a given project, actual salary and indirect labor costs incurred are measured and compared against the total estimated costs of such items at the completion of the project. Revenue is recognized based upon the percentage-of-completion calculation of total incurred costs to total estimated costs. The Company infrequently works on fixed-price projects that include significant amounts of material or other non-labor related costs which could distort the percent complete within a percentage-of-completion calculation. The Company's estimate of the total labor costs it expects to incur over the term of the contract is based on the nature of the project and our past experience on similar projects, and includes management judgments and estimates which affect the amount of revenue recognized on fixed-price contracts in any accounting period. Loss on contracts, if any, are recorded at the time it is determined a loss exists on a project.

The Company's revenue from contracts accounted for under time-and-material, progress billing, and percentage-of-completion methods as a percentage of consolidated revenue for the three years ended December 31, 2017, 2016, and 2015 is as follows:

	2017	2016	2015
Time-and-material	85.9 %	86.5 %	88.6 %
Progress billing	10.8 %	10.8 %	9.5 %
Percentage-of-completion	3.3 %	2.7 %	1.9 %
Total	100.0%	100.0%	100.0%

As of December 31, 2017 and 2016, the backlog for fixed-price and all managed-support contracts was approximately \$30.4 million and \$29.7 million, respectively. Approximately 76% or \$23.0 million of the December 31, 2017 backlog is expected to be earned in 2018. Approximately 71% of the \$29.7 million of backlog at December 31, 2016, or \$21.0 million, was earned in 2017. Revenue is subject to slight seasonal variations, with a minor slowdown and a decrease in billable resource utilization in months of high vacation and legal holidays (July, August, and December). Backlog does not tend to be seasonal; however, it does fluctuate based upon the timing of entry into long-term contracts.

Competition

The IT services market, for both IT solutions and IT staffing services, is highly competitive. The market is also highly fragmented with many providers and no single competitor maintaining clear market leadership. Competition varies by location, the type of service provided, and the client to whom services are provided. The Company's competition comes from four major channels: large national or international companies, including major accounting and consulting firms and large companies headquartered in India; hardware vendors and suppliers of packaged software systems; small local firms or individuals specializing in specific programming services or applications; and from a client's internal IT staff. CTG competes against all four of these channels for its share of the market. The Company believes that to compete successfully it is necessary to have a local geographic presence, offer appropriate IT solutions, provide skilled professional resources, and price its services competitively.

Intellectual Property

The Company has registered its symbol and logo with the U.S. Patent and Trademark Office and has taken steps to preserve its rights in other countries where it operates. We regard patents, trademarks, copyrights and other intellectual property as important to our success, and we rely on them in the United States and foreign countries to protect our investments in products and technology. Our patents expire at various times, but we believe that the loss or expiration of any individual patent would not materially affect our business. We, like any other company, may be

subject to claims of alleged infringement of the patents, trademarks and other intellectual property rights of third parties from time to time in the ordinary course of business. CTG has entered into agreements with various software and hardware vendors from time to time in the normal course of business, and has capitalized certain costs under software development projects.

Employees

CTG's business depends on the Company's ability to attract and retain qualified professional staff to provide services to its clients. The Company has a structured recruiting organization that works with its clients to meet their requirements by recruiting and providing high quality, motivated staff. The Company employs approximately 3,200 employees worldwide, with approximately 2,450 in the United States and Canada and 750 in Europe. Of these employees, approximately 2,850 are IT professionals and 350 are individuals who work in sales, recruiting, delivery,

administrative and support positions. The Company believes that its relationship with its employees is good. No employees are covered by a collective bargaining agreement or are represented by a labor union. CTG is an equal opportunity employer.

Financial Information About Geographic Areas

The following table sets forth certain financial information relating to the performance of the Company for the three years ended December 31, 2017, 2016, and 2015. This information should be read in conjunction with the audited consolidated financial statements and notes thereto included in Item 8, "Financial Statements and Supplementary Data" included in this report.

	2017	2016	2015
(amounts in thousands)			
Revenue from External Clients:			
United States	\$219,886	\$253,955	\$301,826
Belgium ⁽¹⁾	39,347	35,995	35,931
Luxembourg ⁽²⁾	36,954	31,441	28,562
Other European country	4,824	3,193	2,814
Other country	199	309	345
Total foreign revenue	81,324	70,938	67,652
Total revenue	\$301,210	\$324,893	\$369,478
Operating Income (loss):			
United States	\$(158)	\$(35,739)	\$8,922
Belgium ⁽¹⁾	\$594	\$(577)	\$(304)
Luxembourg ⁽²⁾	2,841	2,943	2,720
United Kingdom ⁽³⁾	596	17	(714)
Other countries	71	9	13
Total foreign operating income	4,102	2,392	1,715
Total operating income (loss)	\$3,944	\$(33,347)	