COMPUTER TASK GROUP INC
Form 10-Q
April 29, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended April 3, 2015

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

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 x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 x NO ¨

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Title of each class	Shares outstanding at April 24, 2015
Common stock, par value $.01 per share	18,716,618

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

COMPUTER TASK GROUP, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(amounts in thousands, except per share data)
(Unaudited)

	For the Quarter Ended	
	April 3, 2015	March 28, 2014
Revenue	$97,477	$97,911
Direct costs	80,172	76,979
Selling, general and administrative expenses	15,092	15,457
Operating income	2,213	5,475
Interest and other income	41	18
Interest and other expense	51	115
Income before income taxes	2,203	5,378
Provision for income taxes	936	2,212
Net income	$1,267	$3,166
Net income per share:		
Basic	$0.08	$0.21
Diluted	$0.08	$0.19
Weighted average shares outstanding:		
Basic	15,407	15,153
Diluted	15,928	16,576
Cash dividend declared per share	$0.06	$0.06

The accompanying notes are an integral part of these condensed consolidated financial statements.

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COMPUTER TASK GROUP, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(amounts in thousands)
(Unaudited)

	For the Quarter Ended	
	April 3, 2015	March 28, 2014
Net Income	$1,267	$3,166
Foreign currency adjustment	(1,970)	3
Change in pension loss, net of taxes of $23 and $13 in 2015 and 2014, respectively	915	45
Other comprehensive income (loss)	(1,055)	48
Comprehensive income	$212	$3,214

The accompanying notes are an integral part of these condensed consolidated financial statements.

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COMPUTER TASK GROUP, INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(amounts in thousands, except share balances)
(Unaudited)

	April 3, 2015	December 31, 2014
Assets		
Current Assets:		
Cash and cash equivalents	$34,420	$40,862
Accounts receivable, net of allowances of $678 and $891 in 2015 and 2014, respectively	67,614	67,843
Prepaid and other current assets	2,782	1,817
Income taxes receivable	1,530	1,684
Deferred income taxes	1,139	1,079
Total current assets	107,485	113,285
Property, equipment and capitalized software, net	6,619	6,793
Goodwill	37,218	37,409
Deferred income taxes	6,130	6,364
Other assets	5,373	6,157
Investments	418	788
Total assets	$163,243	$170,796
Liabilities and Shareholders’ Equity		
Current Liabilities:		
Accounts payable	$6,089	$8,865
Accrued compensation	24,391	27,371
Advance billings on contracts	2,054	1,973
Dividend payable	—	896
Other current liabilities	4,933	4,955
Total current liabilities	37,467	44,060
Deferred compensation benefits	14,151	15,480
Other long-term liabilities	286	290
Total liabilities	51,904	59,830
Shareholders’ Equity:		
Common stock, par value $0.01 per share, 150,000,000 shares authorized; 27,017,824 shares issued in both periods	270	270
Capital in excess of par value	125,653	125,884
Retained earnings	119,322	118,999
Less: Treasury stock of 8,295,506 and 8,486,172 shares at cost, in 2015 and 2014, respectively	(62,175)	(63,511)
Stock Trusts of 3,363,351 shares at cost in both periods	(55,083)	(55,083)
Accumulated other comprehensive loss	(16,648)	(15,593)
Total shareholders’ equity	111,339	110,966
Total liabilities and shareholders’ equity	$163,243	$170,796

The accompanying notes are an integral part of these condensed consolidated financial statements.

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COMPUTER TASK GROUP, INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in thousands)
(Unaudited)

	For the Quarter Ended	
	April 3, 2015	March 28, 2014
Cash flow from operating activities:		
Net income	$1,267	$3,166
Adjustments:		
Depreciation and amortization expense	597	837
Equity-based compensation expense	365	551
Deferred income taxes	150	(197)
Deferred compensation	(361)	(36)
Changes in assets and liabilities:		
Increase in accounts receivable	(1,605)	(5,527)
Increase in prepaid and other current assets	(990)	(791)
Decrease in income taxes receivable	174	1,778
Decrease in other assets	756	133
Decrease in accounts payable	(2,787)	(2,108)
Decrease in accrued compensation	(2,293)	(6,616)
Increase (decrease) in advance billings on contracts	135	(186)
Increase (decrease) in other current liabilities	183	(272)
Decrease in other long-term liabilities	(4)	(7)
Net cash used in operating activities	(4,413)	(9,275)
Cash flow from investing activities:		
Additions to property and equipment	(324)	(304)
Additions to capitalized software	(188)	(497)
Deferred compensation plan investments, net	374	59
Net cash used in investing activities	(138)	(742)
Cash flow from financing activities:		
Proceeds from stock option plan exercises	1,375	231
Excess tax benefits from equity-based compensation	247	269
Proceeds from Employee Stock Purchase Plan	76	90
Change in cash overdraft, net	108	(159)
Dividends paid	(1,814)	(748)
Purchase of stock for treasury	(798)	(3,596)
Net cash used in financing activities	(806)	(3,913)
Effect of exchange rates on cash and cash equivalents	(1,085)	12
Net decrease in cash and cash equivalents	(6,442)	(13,918)
Cash and cash equivalents at beginning of year	40,862	46,227
Cash and cash equivalents at end of quarter	$34,420	$32,309

The accompanying notes are an integral part of these condensed consolidated financial statements.

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COMPUTER TASK GROUP, INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Financial Statements

The condensed consolidated financial statements included herein reflect, in the opinion of the management of Computer Task Group, Incorporated (“CTG” or “the Company”), all normal recurring adjustments necessary to present fairly the condensed consolidated financial position, results of operations and comprehensive income, and cash flows for the periods presented.

The Company's fiscal year-end is December 31. During the year, the quarters generally consist of a 13-week fiscal quarter where the last day of each of the first three quarters is a Friday. The 2015 first quarter began on January 1, 2015 and ended on April 3, 2015. The 2014 first quarter began on January 1, 2014 and ended March 28, 2014. There were 66 and 62 billable days in the first quarters of 2015 and 2014, respectively. In 2015, the Company added one week to its first quarter so that its fiscal quarter-end date of April 3 would approximate the calendar quarter-end date of March 31, and removed one week from the fourth quarter which will end on December 31, 2015.

2. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

These condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the SEC rules and regulations. There are no unconsolidated entities, or off-balance sheet arrangements other than certain guarantees supporting office leases and the performance under government contracts in the Company's European operations. All inter-company accounts and transactions have been eliminated.

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles requires the Company's management to make estimates, judgments and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Such estimates include, but are not limited to, the valuation of goodwill and other intangible assets, valuation allowances for deferred tax assets, actuarial assumptions including discount rates and expected rates of return on assets, as applicable, for the Company's defined benefit plans, the allowance for doubtful accounts receivable, assumptions underlying stock option valuation, investment valuation, legal matters, other contingencies, and progress toward completion and direct profit or loss on contracts. Management believes that the information and disclosures provided herein are adequate to present fairly the condensed consolidated financial position, results of operations and comprehensive income, and cash flows of the Company. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's latest Annual Report on Form 10 K filed with the SEC.

The Company operates in one industry segment, providing IT services to its clients. These services include IT solutions and IT staffing. CTG provides these primary services to all of the markets that it serves. The services provided typically encompass the IT business solution life cycle, including phases for planning, developing, implementing, managing, and ultimately maintaining the IT solution. A typical customer is an organization with large, complex information and data processing requirements.

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IT solutions and IT staffing revenue as a percentage of total revenue for the quarters ended April 3, 2015 and March 28, 2014 was as follows:

	For the Quarter Ended			
	April 3, 2015		March 28, 2014	
IT solutions	33.1	%	39.3	%
IT staffing	66.9	%	60.7	%
Total	100.0	%	100.0	%

The Company promotes a significant portion of its services through four vertical market focus areas: Technology Service Providers, Healthcare (which includes services provided to healthcare providers, health insurers, and life sciences companies), Financial Services, and Energy. The Company focuses on these four vertical areas as it believes that these areas are either higher growth markets than the general IT services market and the general economy, or are areas that provide greater potential for the Company's growth due to the size of the vertical market. The remainder of CTG's revenue is derived from general markets.

CTG's revenue by vertical market for the quarters ended April 3, 2015 and March 28, 2014 was as follows:

	For the Quarter Ended			
	April 3, 2015		March 28, 2014	
Technology service providers	28.5	%	24.9	%
Healthcare	24.1	%	30.2	%
Financial services	7.0	%	8.1	%
Energy	5.6	%	6.2	%
General markets	34.8	%	30.6	%
Total	100.0	%	100.0	%

Fair Value

Fair value is defined as the exchange price that would be received for an asset or paid for a liability in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants. The Company utilizes a fair value hierarchy for its assets and liabilities, as applicable, based upon three levels of input, which are:

Level 1—quoted prices in active markets for identical assets or liabilities (observable)

Level 2—inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in inactive markets, or other inputs that are observable or can be supported by observable market data for essentially the full term of the asset or liability (observable)

Level 3—unobservable inputs that are supported by little or no market activity, but are significant to determining the fair value of the asset or liability (unobservable)

At April 3, 2015 and December 31, 2014, the carrying amounts of the Company's cash of $34.4 million and $40.9 million, respectively, approximated fair value.

The Company is also allowed to elect an irrevocable option to measure, on a contract by contract basis, specific financial instruments and certain other items that are currently not being measured at fair value. The Company did not elect to apply the fair value provisions of this accounting standard for any specific contracts during the quarters ended April 3, 2015 or March 28, 2014.

Life Insurance Policies

The Company has purchased life insurance on the lives of a number of former employees who are plan participants in the non-qualified defined benefit Executive Supplemental Benefit Plan. Those policies have generated cash surrender value, and the Company has taken loans against the policies. At April 3, 2015 and

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December 31, 2014, these insurance policies have a gross cash surrender value of $27.8 million and $27.6 million, respectively, outstanding loans and interest total $23.4 million and $23.1 million, respectively, and net cash surrender value balances of $4.4 million and $4.5 million, respectively, which are included on the consolidated balance sheet in “Other Assets” under non-current assets.
At April 3, 2015 and December 31, 2014, the total death benefit for the remaining policies was approximately $39.1 million and $38.8 million, respectively. Currently, upon the death of all of the remaining plan participants, the Company would expect to receive approximately $15.1 million after the payment of outstanding loans, and, under current tax regulations, record a non-taxable gain of approximately $10.7 million.

Taxes Collected from Customers

In instances where the Company collects taxes from its customers for remittance to governmental authorities, primarily in its European operations, revenue and expenses are not presented on a gross basis in the consolidated financial statements as such taxes are recorded in the Company's accounts on a net basis.

Cash and Cash Equivalents, and Cash Overdrafts

For purposes of the statement of cash flows, cash and cash equivalents are defined as cash on hand, demand deposits, and short-term, highly liquid investments with a maturity of three months or less. As the Company does not fund its bank accounts for the checks it has written until the checks are presented to the bank for payment, the "change in cash overdraft, net," as presented on the condensed consolidated statements of cash flows represents the increase or decrease in outstanding checks quarter-over-quarter.

Property, Equipment and Capitalized Software Costs

Property, equipment and capitalized software at April 3, 2015 and December 31, 2014 are summarized as follows:

(amounts in thousands)	April 3, 2015	December 31, 2014
Property, equipment and capitalized software	$27,251	$27,487
Accumulated depreciation and amortization	(20,632)	(20,694)
Property, equipment and capitalized software, net	$6,619	$6,793

The Company recorded $0.2 million and $0.5 million of capitalized software costs during the quarters ended April 3, 2015 and March 28, 2014, respectively. As of those dates, the Company had capitalized a total of $5.7 million and $6.3 million, respectively, for software projects developed for internal use. Amortization periods range from two to five years, and are evaluated annually for propriety. Amortization expense totaled $0.2 million and $0.4 million in the quarters ended April 3, 2015 and March 28, 2014, respectively. Accumulated amortization for these projects totaled $4.4 million and $3.8 million as of April 3, 2015 and March 28, 2014, respectively.

Guarantees

The Company has several guarantees in place in our European operations which support office leases and performance under government contracts. These guarantees total approximately $1.3 million and $1.6 million at April 3, 2015 and December 31, 2014, respectively, and generally have expiration dates ranging from April 2015 through December 2019.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," ("ASU 2014-09"). ASU 2014-09 outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new revenue recognition model provides a five-step analysis in determining when and how revenue is recognized. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods or services. The pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15,

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2016, and early adoption is not permitted. The Company is currently assessing the impact that adopting this new accounting guidance will have on its consolidated financial statements and footnote disclosures.

3. Net Income Per Share

Basic and diluted earnings per share (EPS) for the quarters ended April 3, 2015 and March 28, 2014 was as follows:

(amounts in thousands, except per-share data)	For the Quarter Ended April 3, 2015	March 28, 2014
Weighted-average number of shares outstanding during period	15,407	15,153
Common stock equivalents - incremental shares primarily under stock option plans	521	1,423
Number of shares on which diluted earnings per share is based	15,928	16,576
Net income	$1,267	$3,166
Net income per share		
Basic	$0.08	$0.21
Diluted	$0.08	$0.19

Weighted-average shares represent the average number of issued shares less treasury shares and shares held in the Stock Trusts, and for the basic EPS calculations, unvested restricted stock.

Certain options representing 0.6 million and 0.3 million shares of common stock were outstanding at April 3, 2015 and March 28, 2014, respectively, but were not included in the computation of diluted earnings per share as their effect on the computation would have been anti-dilutive.

4. Investments

The Company’s investments consist of mutual funds which are part of the Computer Task Group, Incorporated Non-qualified Key Employee Deferred Compensation Plan. At April 3, 2015 and December 31, 2014, the Company’s investment balances, which are classified as trading securities, totaled approximately $0.4 million and $0.8 million, respectively, and are measured at fair value. As there is an active trading market for these funds, fair value was determined using Level 1 inputs (see note 2 for “Fair Value”). Unrealized gains and losses on these securities are recorded in earnings and were nominal in both the 2015 and 2014 first quarters.

5. Accumulated Other Comprehensive Loss

The components that make up accumulated other comprehensive loss on the condensed consolidated balance sheets at April 3, 2015 and December 31, 2014 are as follows:

(amounts in thousands)	April 3, 2015	December 31, 2014
Foreign currency adjustment	$(7,781)	$(5,811)
Pension loss adjustment, net of tax of $1,210 in 2015, and $1,233 in 2014	(8,867)	(9,782)