

COMPUTER TASK GROUP INC

Form 10-K

February 23, 2016

Table of Contents

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, 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

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

Title of each class

Name of each exchange on which registered

Common Stock, \$.01 par value

The NASDAQ Stock Market LLC

Rights to Purchase Series A

The NASDAQ Stock Market LLC

Participating Preferred Stock

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, 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 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

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 \$115.9 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 February 19, 2016 was 19,043,209.

DOCUMENTS INCORPORATED BY REFERENCE

Certain sections of the Company’s definitive proxy statement to be filed with the Securities and Exchange Commission (SEC) within 120 days of the end of the Company’s fiscal year ended December 31, 2015, are incorporated by reference into Part III hereof. Except for those portions specifically incorporated by reference herein, such document shall not be deemed to be filed with the SEC as part of this annual report on Form 10-K.

Table of Contents

SEC Form 10-K Index

Section	Page
Part I	
Item 1. <u>Business</u>	<u>1</u>
Item 1A. <u>Risk Factors</u>	<u>7</u>
Item 1B. <u>Unresolved Staff Comments</u>	<u>12</u>
Item 2. <u>Properties</u>	<u>12</u>
Item 3. <u>Legal Proceedings</u>	<u>12</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>12</u>
Part II	
Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>13</u>
Item 6. <u>Selected Financial Data</u>	<u>15</u>
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>16</u>
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>28</u>
Item 8. <u>Financial Statements and Supplementary Data</u>	<u>29</u>
Item 9. <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>57</u>
Item 9A. <u>Controls and Procedures</u>	<u>57</u>
Item 9B. <u>Other Information</u>	<u>59</u>
Part III	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	<u>60</u>
Item 11. <u>Executive Compensation</u>	<u>61</u>
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>61</u>
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	<u>61</u>
Item 14. <u>Principal Accounting Fees and Services</u>	<u>62</u>
Part IV	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	<u>63</u>

Table of Contents

As used in this annual report on Form 10-K, references to “CTG,” “the Company” or “the Registrant” refer to Computer Task Group, Incorporated and its subsidiaries, unless the context suggests otherwise.

PART I

Forward-Looking Statements

This annual report on Form 10-K contains forward-looking statements made by the management of Computer Task Group, Incorporated (CTG, the Company or the Registrant) that are subject to a number of risks and uncertainties. These forward-looking statements are based on information as of the date of this report. The Company assumes no obligation to update these statements based on information from and after the date of this report. Generally, forward-looking statements include words or phrases such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “projects,” “could,” “may,” “might,” “should,” “will” and words and phrases of similar impact. The forward-looking statements include, but are not limited to, statements regarding future operations, industry trends or conditions and the business environment, and statements regarding future levels of or trends in business strategy and expectations, new business opportunities, cost control initiatives, business wins, market demand, revenue, operating expenses, capital expenditures, and financing. The forward-looking statements are made pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Numerous factors could cause actual results to differ materially from those in the forward-looking statements, including the following: (i) the availability to CTG of qualified professional staff, (ii) domestic and foreign industry competition for customers and talent, (iii) increased bargaining power of large customers, (iv) the Company's ability to protect confidential client data, (v) the partial or complete loss of the revenue the Company generates from International Business Machines Corporation (IBM) for SDI International (SDI), (vi) the uncertainty of customers' implementations of cost reduction projects, (vii) the effect of healthcare reform and initiatives, (viii) the mix of work between staffing and solutions, (ix) currency exchange risks, (x) risks associated with operating in foreign jurisdictions, (xi) renegotiations, nullification, or breaches of contracts with customers, vendors, subcontractors or other parties, (xii) the change in valuation of recorded goodwill, (xiii) the impact of current and future laws and government regulation, as well as repeal or modification of such, affecting the information technology (IT) solutions and staffing industry, taxes and the Company's operations in particular, (xiv) industry and economic conditions, including fluctuations in demand for IT services, (xv) consolidation among the Company's competitors or customers, (xvi) the need to supplement or change our IT services in response to new offerings in the industry or changes in customer requirements for IT products and solutions, (xvii) the risks associated with acquisitions, and (xviii) the risks described in Item 1A of this annual report on Form 10-K and from time to time in the Company's reports filed with the Securities and Exchange Commission (SEC).

Item 1. Business

Overview

CTG was incorporated in Buffalo, New York on March 11, 1966, and its corporate headquarters are located at 800 Delaware Avenue, Buffalo, New York 14209 (716-882-8000). CTG is an IT solutions and staffing services company with operations in North America and Europe. CTG employs approximately 3,600 people worldwide. During 2015, the Company had seven operating subsidiaries: Computer Task Group of Canada, Inc., providing services in Canada; and Computer Task Group Belgium N.V., CTG ITS S.A., Computer Task Group IT Solutions, S.A., Computer Task Group Luxembourg PSF, Computer Task Group (U.K.) Ltd., and etrinity N.V. (etrinity), each primarily providing services in Europe. Services provided in North America are primarily performed by the parent corporation, CTG.

Services

The Company primarily operates in one industry segment, providing IT services to its clients. At the highest level, CTG delivers services that are considered either IT solutions or IT and other staffing. CTG delivers 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. 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

1

Table of Contents

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.

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 companies with multiple locations and significant need for high-volume external IT, administrative, or other resources.

IT solutions and staffing revenue as a percentage of consolidated revenue for the years ended December 31, 2015, 2014 and 2013 is as follows:

	2015	2014	2013			
IT solutions	33.0	% 38.0	% 39.4	%		
IT and other staffing	67.0	% 62.0	% 60.6	%		
Total	100.0	% 100.0	% 100.0	%		

Included within its IT solutions and IT and other staffing services, CTG delivers two additional services:

Strategy: CTG’s strategic consulting engagements deliver customized recommendations and plans that address business and IT challenges and maximize the realization of benefits. CTG subject matter experts apply business and IT insights to guide clients through business challenges via effective use of technology, from IT strategy and system selection, to workflow process design. Strategy engagements support enterprise, network, and security architecture, business and IT alignment, regulatory and compliance mandates, and IT performance optimization.

Services: CTG’s services deliver ongoing support with service-level responsibility for a range of IT functions to ensure system availability and high client satisfaction. CTG provides multi-tier expertise for the management of mission-critical enterprise IT functions including help and service desk, infrastructure maintenance, application management and support, and technical and business monitoring.

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 accrued 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.

Table of Contents

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.

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 Diversified Industrials. 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 years ended December 31, 2015, 2014 and 2013 is as follows:

	2015	2014	2013		
Technology service providers	31.1	% 26.4	% 28.1	%	
Manufacturing	25.7	% 23.8	% 20.9	%	
Healthcare	23.5	% 28.6	% 31.3	%	
Financial services	7.1	% 7.9	% 6.8	%	
Diversified industrials	5.4	% 6.1	% 6.2	%	
General markets	7.2	% 7.2	% 6.7	%	
Total	100.0	% 100.0	% 100.0	%	

Revenue for the Company's technology service providers vertical market as a percentage of total revenue increased in 2015 as compared with 2014 due to strong demand for the first three quarters of 2015 from several of the Company's largest clients in its IT staffing services business unit, which are included in this vertical market. Demand from this vertical did slow significantly in the 2015 fourth quarter, however, as several large customers 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 customers, including Lenovo (through SDI as a vendor manager for Lenovo). Revenue from Lenovo increased by approximately \$7 million in 2015 as compared with 2014 primarily as a result of the acquisition from IBM of the x86 server business.

Previously, the Company's growth efforts were primarily focused in the healthcare market based on its leading position in serving the provider market, and its expertise and experience serving other segments of this market, primarily payers and life sciences companies. In 2012, there was higher demand for solutions offerings and support from healthcare companies, and in general, higher demand compared with other sectors of the U.S. economy. However, in 2013 and 2014, the demand from our healthcare clients decreased. This decrease was 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 EHR and related projects, declined in 2013 and 2014, and continued to decrease in 2015. As part of the strategy in 2016 to shift to other non-EHR services, the Company combined the delivery of the services of its healthcare and life sciences business under one individual, and has expanded its healthcare IT business development team with individuals who have experience selling other (non-EHR) healthcare IT services such as advisory and technical services, outsourcing, and staff augmentation. During 2015, the percentage of revenue attributable to the financial services market decreased from 2014, primarily due to the fact that most of the revenue generated in this vertical market is in Europe, and there was a significant decrease in the value of the Euro and British pound in 2015 as compared with 2014.

Table of Contents

Revenue for the Company's diversified industrials vertical market decreased as a percentage of consolidated revenue in 2015 as compared with 2014 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, during 2014 and 2015.

For the year ended December 31, 2015, CTG provided its services to approximately 350 clients in North America and Europe. In North America, the Company operates in the United States and Canada, with greater than 99% of 2015 North American revenue generated in the United States. In Europe, the Company operates in Belgium, Luxembourg, and the United Kingdom. Of total 2015 consolidated revenue of \$369.5 million, approximately 82% was generated in North America and 18% in Europe. Two clients, IBM and SDI, each accounted for greater than 10% of CTG's consolidated revenue in 2015.

Pricing 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 time-and-material contracts, revenue is recognized as hours are incurred and costs are expended. For contracts with periodic billing schedules, primarily monthly, revenue is recognized as services are rendered to the customer. 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.

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 years ended December 31, 2015, 2014 and 2013 is as follows:

	2015	2014	2013	
Time-and-material	88.6	% 86.2	% 88.8	%
Progress billing	9.5	% 11.2	% 8.8	%
Percentage-of-completion	1.9	% 2.6	% 2.4	%
Total	100.0	% 100.0	% 100.0	%

As of December 31, 2015 and 2014, the backlog for fixed-price and all managed-support contracts was approximately \$30.2 million and \$41.8 million, respectively. Approximately 76.0% or \$23.0 million of the December 31, 2015 backlog is expected to be earned in 2016. Of the \$41.8 million of backlog at December 31, 2014, approximately 66.9%, or \$28.0 million was earned in 2015. Revenue is subject to slight seasonal variations, with a minor slowdown 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 customer 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; hardware vendors and suppliers of packaged software systems; small local firms or individuals specializing in specific programming services or applications; and from a customer'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.

Table of Contents

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 customers. 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 3,600 employees worldwide, with approximately 2,900 in the United States and Canada and 700 in Europe. Of these employees, approximately 3,300 are IT professionals and 300 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.

Table of Contents

Financial Information About Geographic Areas

The following table sets forth certain financial information relating to the performance of the Company for the years ended December 31, 2015, 2014, and 2013. 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.

	2015	2014	2013
(amounts in thousands)			
Revenue from External Customers:			
United States	\$301,826	\$314,500	\$341,391
Belgium ⁽¹⁾	35,931	44,692	