SYKES ENTERPRISES INC
Form 10-Q
May 06, 2009

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2009

o **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. 0-28274
Sykes Enterprises, Incorporated
(Exact name of Registrant as specified in its charter)

Florida	**56-1383460**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

400 North Ashley Drive, Tampa, FL 33602
(Address of principal executive offices) (Zip Code)
Registrant s telephone number, including area code: (813) 274-1000

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 at least the past 90 days.
Yes þ No o

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 (§ 229.405 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 o No o

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. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

As of April 24, 2009, there were 41,243,865 outstanding shares of common stock.

Sykes Enterprises, Incorporated and Subsidiaries

INDEX

Table of Contents

PART I FINANCIAL INFORMATION
Item 1 Financial Statements

Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

(in thousands, except per share data)	March 31, 2009	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	**$ 208,976**	$ 219,050
Receivables, net	**158,022**	157,067
Prepaid expenses	**11,204**	7,084
Other current assets	**12,721**	13,317
Total current assets	**390,923**	396,518
Property and equipment, net	**79,558**	80,390
Goodwill	**21,884**	23,191
Intangibles, net	**4,033**	4,586
Deferred charges and other assets	**24,551**	24,857
	$ 520,949	$ 529,542
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	**$ 20,028**	$ 26,419
Accrued employee compensation and benefits	**46,136**	47,194
Income taxes payable	**4,222**	4,485
Deferred revenue	**25,552**	26,955
Other accrued expenses and current liabilities	**18,050**	21,057
Total current liabilities	**113,988**	126,110
Deferred grants	**12,099**	9,340
Long-term income tax liabilities	**5,082**	5,077
Other long-term liabilities	**4,858**	4,985
Total liabilities	**136,027**	145,512
Loss contingency (Note 14)		
Shareholders equity:		
Preferred stock, $0.01 par value, 10,000 shares authorized; no shares issued and outstanding		

Common stock, $0.01 par value, 200,000 shares authorized; 41,472 and 41,271 shares issued	**415**	413
Additional paid-in capital	**158,961**	158,216
Retained earnings	**251,958**	237,188
Accumulated other comprehensive loss	**(21,999)**	(10,683)
Treasury stock at cost: 327 shares and 96 shares	**(4,413)**	(1,104)
Total shareholders equity	**384,922**	384,030
	$ 520,949	$ 529,542

See accompanying notes to condensed consolidated financial statements.

3

Table of Contents

Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended March 31,	
(in thousands, except for per share data)	**2009**	**2008**
Revenues	**$ 203,241**	$ 203,721
Operating expenses:		
Direct salaries and related costs	**130,253**	130,980
General and administrative	**55,489**	56,424
Total operating expenses	**185,742**	187,404
Income from operations	**17,499**	16,317
Other income (expense):		
Interest income	**851**	1,822
Interest (expense)	**(114)**	(102)
Other income	**821**	531
Total other income (expense)	**1,558**	2,251
Income before provision for income taxes	**19,057**	18,568
Provision for income taxes	**4,287**	2,858
Net income	**$ 14,770**	$ 15,710
Net income per share:		
Basic	**$ 0.36**	$ 0.39
Diluted	**$ 0.36**	$ 0.38
Weighted average shares:		
Basic	**40,630**	40,491
Diluted	**41,034**	40,813

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Statements of Changes in Shareholders Equity
Three Months Ended March 31, 2008, Nine Months Ended December 31, 2008 and Three Months Ended March 31, 2009
(Unaudited)

(In thousands)	Common Stock Shares Issued	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at January 1, 2008	45,537	$455	$184,184	$195,203	$ 37,457	$(51,978)	$365,321
Adjustment upon adoption of EITF 06-10				(482)			(482)
Issuance of common stock	60	1	678				679
Stock-based compensation expense			1,246				1,246
Issuance of common stock and restricted stock under equity award plans	190	1	94			(96)	(1)
Retirement of treasury stock	(4,543)	(45)	(33,031)	(18,094)		51,170	
Comprehensive income				15,710	303		16,013
Balance at March 31, 2008	41,244	412	153,171	192,337	37,760	(904)	382,776
Issuance of common stock	45		495				495
Stock-based compensation expense			3,510				3,510
Excess tax benefit from stock- based compensation			712				712
Issuance of common stock and restricted stock under equity award	46	2	(33)			(4)	(35)

plans							
Repurchase of common stock						(512)	(512)
Retirement of treasury stock	(101)	(1)	(315)			316	
Issuance of common stock for business acquisition	37		676				676
Comprehensive income (loss)				44,851	(48,443)		(3,592)
Balance at December 31, 2008	41,271	413	158,216	237,188	(10,683)	(1,104)	384,030
Stock-based compensation expense			**1,616**				**1,616**
Excess tax benefit from stock- based compensation			**79**				**79**
Issuance of common stock and restricted stock under equity award plans	**201**	**2**	**(950)**			**(116)**	**(1,064)**
Repurchase of common stock						**(3,193)**	**(3,193)**
Comprehensive income (loss)				**14,770**	**(11,316)**		**3,454**
Balance at March 31, 2009	**41,472**	**$415**	**$158,961**	**$251,958**	**$(21,999)**	**$ (4,413)**	**$384,922**

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows
Three months ended March 31, 2009 and 2008
(Unaudited)

(in thousands)	**2009**	**2008**
Cash flows from operating activities:		
Net income	**$ 14,770**	$ 15,710
Depreciation and amortization, net	**6,776**	7,019
Unrealized foreign currency transaction gains, net	**(284)**	
Stock-based compensation expense	**1,616**	1,246
Excess tax benefit from stock-based compensation	**(79)**	
Deferred income tax provision (benefit)	**884**	(186)
Net loss on disposal of property and equipment	**37**	
Foreign exchange loss (gain) on liquidation of foreign entities	**5**	(11)
Bad debt expense	**595**	224
Write down of value added tax receivables	**209**	169
Unrealized loss on financial instruments, net	**85**	691
Amortization of discount on short-term investments		(173)
Amortization of actuarial gains on pension		(17)
Changes in assets and liabilities:		
Receivables	**(6,202)**	(16,132)
Prepaid expenses	**(4,426)**	(3,941)
Other current assets	**(222)**	491
Deferred charges and other assets	**(1,151)**	804
Accounts payable	**(2,083)**	(2,133)
Income taxes receivable/payable	**(394)**	(1,197)
Accrued employee compensation and benefits	**(1,164)**	(2,247)
Other accrued expenses and current liabilities	**(692)**	753
Deferred revenue	**(388)**	(632)
Other long-term liabilities	**154**	598
Net cash provided by operating activities	**8,046**	1,036
Cash flows from investing activities:		
Capital expenditures	**(11,057)**	(8,063)
Proceeds from sale of property and equipment	**6**	51
Proceeds from release of restricted cash		373
Sale of short-term investments		17,535
Purchase of short-term investments		(175)
Investment in restricted cash		(1,001)
Other		(128)
Net cash (used for) provided by investing activities	**(11,051)**	8,592
Cash flows from financing activities:		
Proceeds from issuance of stock		679
Excess tax benefit from stock-based compensation	**79**	
Cash paid for repurchase of common stock	**(3,193)**	

Proceeds from grants	**3,440**	
Proceeds from short-term debt		26
Payments on short-term debt		(26)
Net cash provided by financing activities	**326**	679
Effects of exchange rates on cash	**(7,395)**	1,674
Net (decrease) increase in cash and cash equivalents	**(10,074)**	11,981
Cash and cash equivalents beginning	**219,050**	177,682
Cash and cash equivalents ending	**$ 208,976**	$ 189,663

6

Table of Contents

Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows
Three months ended March 31, 2009 and 2008
(Unaudited)

(continued)

(In thousands)	**2009**	**2008**
Supplemental disclosures of cash flow information:		
Cash paid during period for interest	**$ 70**	$ 67
Cash paid during period for income taxes	**$ 3,552**	$ 4,061
Non-cash transactions:		
Property and equipment additions included in accounts payable	**$ 1,691**	$ 1,681
Shares repurchased for minimum tax withholding on common stock and restricted stock under equity awards plans included in other accrued expenses and current liabilities	**$ 1,063**	$

See accompanying notes to condensed consolidated financial statements.

7

Table of Contents

Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Three months ended March 31, 2009 and 2008
(Unaudited)

Sykes Enterprises, Incorporated and consolidated subsidiaries (SYKES or the Company) provides outsourced customer contact management solutions and services in the business process outsourcing arena to companies, primarily within the communications, financial services, healthcare, technology/consumer and transportation and leisure industries. SYKES provides flexible, high quality outsourced customer contact management services (with an emphasis on inbound technical support and customer service), which includes customer assistance, healthcare and roadside assistance, technical support and product sales to its clients customers. Utilizing SYKES integrated onshore/offshore global delivery model, SYKES provides its services through multiple communications channels encompassing phone, e-mail, Web and chat. SYKES complements its outsourced customer contact management services with various enterprise support services in the United States that encompass services for a company s internal support operations, from technical staffing services to outsourced corporate help desk services. In Europe, SYKES also provides fulfillment services including multilingual sales order processing via the Internet and phone, payment processing, inventory control, product delivery and product returns handling. The Company has operations in two geographic regions entitled (1) the Americas, which includes the United States, Canada, Latin America, India and the Asia Pacific Rim, in which the client base is primarily companies in the United States that are using the Company s services to support their customer management needs; and (2) EMEA, which includes Europe, the Middle East and Africa.

Note 1 Basis of Presentation and Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2009 are not necessarily indicative of the results that may be expected for any future quarters or the year ending December 31, 2009. For further information, refer to the consolidated financial statements and notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the Securities and Exchange Commission (SEC).

Property and Equipment The carrying value of property and equipment to be held and used is evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* . For purposes of recognition and measurement of an impairment loss, assets are grouped at the lowest levels for which there are identifiable cash flows (the reporting unit). An asset is considered to be impaired when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition does not exceed its carrying amount. The amount of the impairment loss, if any, is measured as the amount by which the carrying value of the asset exceeds its estimated fair value, which is generally determined based on appraisals or sales prices of comparable assets. Occasionally, the Company redeploys property and equipment from under-utilized centers to other locations to improve capacity utilization if it is determined that the related undiscounted future cash flows in the under-utilized centers would not be sufficient to recover the carrying amount of these assets. The Company determined that its property and equipment was not impaired as of March 31, 2009.

Goodwill The Company accounts for goodwill and other intangible assets under SFAS No. 142 (SFAS 142), *Goodwill and Other Intangible Assets*. Goodwill and other intangible assets with indefinite lives are not subject to amortization, but instead must be reviewed at least annually, and more frequently in the presence of certain circumstances, for impairment by applying a fair value based test. Fair value for goodwill is based on discounted cash flows, market multiples and/or appraised values as appropriate. Under SFAS 142, the carrying value of assets is calculated at the lowest levels for which there are identifiable cash flows (the reporting unit). If the fair value of the reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the fair value of the goodwill within the reporting unit is less than its carrying value. The Company completed its annual goodwill impairment test during the third quarter of 2008, which included the consideration of recent economic developments

Table of Contents

Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Three months ended March 31, 2009 and 2008
(Unaudited)

Note 1 Basis of Presentation and Summary of Significant Accounting Policies (continued)

Goodwill (continued)

and determined that the carrying amount of goodwill was not impaired. The Company expects to receive future benefits from previously acquired goodwill over an indefinite period of time.

Intangible Assets Intangible assets, primarily customer relationships, existing technologies and covenants not to compete, are amortized using the straight-line method over their estimated useful lives which approximates the pattern in which the economic benefits of the assets are consumed. The Company periodically evaluates the recoverability of intangible assets and takes into account events or changes in circumstances that warrant revised estimates of useful lives or that indicate that impairment exists. Fair value for intangible assets is based on discounted cash flows, market multiples and/or appraised values as appropriate. The Company does not have intangible assets with indefinite lives.

Value Added Tax Receivables The Philippine operations are subject to Value Added Tax (VAT), which is usually applied to all goods and services purchased throughout the Philippines. Upon validation and certification of the VAT receivables by the Philippine government, the VAT receivables are held for sale through third-party brokers. This process through collection typically takes three to five years. The VAT receivables balance recorded at net realizable value, which approximates fair value, is approximately $7.5 million and $7.5 million as of March 31, 2009 and December 31, 2008, respectively. See fair value measurements in this Note 1 for further information. As of March 31, 2009 and December 31, 2008, the VAT receivables of $5.5 million and $4.9 million, respectively, are included in Deferred charges and other assets , $1.1 million and $1.1 million, respectively, are included in Other current assets and $0.9 million and $1.5 million, respectively, are included in Receivables in the accompanying Condensed Consolidated Balance Sheets. During the three months ended March 31, 2009 and 2008, the Company wrote down the VAT receivables balance by $0.2 million and $0.2 million, respectively.

Stock-Based Compensation The Company has three stock-based compensation plans: the 2001 Equity Incentive Plan (for employees and certain non-employees), the 2004 Non-Employee Director Fee Plan (for non-employee directors), both approved by the shareholders, and the Deferred Compensation Plan (for certain eligible employees). All of these plans are discussed more fully in Note 12. Stock-based awards under these plans may consist of common stock, common stock units, stock options, cash-settled or stock-settled stock appreciation rights, restricted stock and other stock-based awards. The Company issues common stock and treasury stock to satisfy stock option exercises or vesting of stock awards.

The Company recognizes in its statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees and directors. Compensation expense for equity-based awards is recognized over the requisite service period, usually the vesting period, while compensation expense for liability-based awards (those usually settled in cash rather than stock) is measured to fair-value at each balance sheet date until the award is settled.

Fair Value Measurements Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157 (SFAS 157), *Fair Value Measurements* and SFAS No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment to FASB Statement No. 115* . SFAS 157, which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

SFAS 159 permits an entity to measure certain financial assets and financial liabilities at fair value with changes in fair value recognized in earnings each period. Since the date of adoption on January 1, 2008, the Company has not elected to use the fair value option permitted under SFAS 159 for any of its financial assets and financial liabilities that are not already recorded at fair value.

Table of Contents

Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Three months ended March 31, 2009 and 2008
(Unaudited)

Note 1 Basis of Presentation and Summary of Significant Accounting Policies (continued)

Fair Value Measurements (continued)

A description of the Company s policies regarding fair value measurement is summarized below.

Fair Value Hierarchy SFAS 157 requires disclosure about how fair value is determined for assets and liabilities and establishes a hierarchy for which these assets and liabilities must be grouped, based on significant levels of observable or unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company s market assumptions. This hierarchy requires the use of observable market data when available. These two types of inputs have created the following fair-value hierarchy:

Level 1 Quoted prices for *identical* instruments in active markets.

Level 2 Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are *unobservable.*

Determination of Fair Value The Company generally uses quoted market prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access to determine fair value, and classifies such items in Level 1. Fair values determined by Level 2 inputs utilize inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted market prices in active markets for similar assets or liabilities, and inputs other than quoted market prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

If quoted market prices are not available, fair value is based upon internally developed valuation techniques that use, where possible, current market-based or independently sourced market parameters, such as interest rates, currency rates, etc. Assets or liabilities valued using such internally generated valuation techniques are classified according to the lowest level input or value driver that is significant to the valuation. Thus, an item may be classified in Level 3 even though there may be some significant inputs that are readily observable.

The following section describes the valuation methodologies used by the Company to measure fair value, including an indication of the level in the fair value hierarchy in which each asset or liability is generally classified.

Money Market Funds and Open-end Mutual Funds The Company uses quoted market prices in active markets to determine the fair value of money market funds and open-end mutual funds, which are classified in Level 1 of the fair value hierarchy.

Foreign Currency Forward Contracts The Company enters into foreign currency forward contracts over the counter and values such contracts using a discounted cash flows model. The key inputs include forward foreign currency exchange rates and interest rates. The item is classified in Level 2 of the fair value hierarchy.

Investments Held in Rabbi Trust The Company maintains a non-qualified deferred compensation plan structured as a rabbi trust for certain eligible employees. The investment assets of the rabbi trust are valued using quoted market prices multiplied by the number of shares held in the trust, which are classified in Level 1 of the fair value hierarchy. For additional information about our deferred compensation plan, refer to Notes 5 and 12.

Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Three months ended March 31, 2009 and 2008
(Unaudited)

Note 1 Basis of Presentation and Summary of Significant Accounting Policies (continued)

Fair Value Measurements (continued)

Guaranteed Investment Certificates Guaranteed investment certificates, with variable interest rates linked to the prime rate, approximate fair value due to the automatic ability to reprice with changes in the market; such items are classified in Level 2 of the fair value hierarchy.

Value Added Tax Receivables The VAT receivables are recorded at net realizable value, which approximates fair value. The Company determines the net realizable value based on estimated discounted future cash flows using such factors as historical sales experience and current market conditions. Such items are classified in Level 3 of the fair value hierarchy.

Foreign Currency Translation The assets and liabilities of the Company s foreign subsidiaries, whose functional currency is other than the U.S. Dollar, are translated at the exchange rates in effect on the reporting date, and income and expenses are translated at the weighted average exchange rate during the period. The net effect of translation gains and losses is not included in determining net income, but is included in Accumulated other comprehensive income (loss) , which is reflected as a separate component of shareholders equity until the sale or until the complete or substantially complete liquidation of the net investment in the foreign subsidiary. Foreign currency transactional gains and losses are included in Other income (expense) in the accompanying Condensed Consolidated Statements of Operations.

Foreign Currency and Derivative Instruments The Company accounts for financial derivative instruments utilizing SFAS No. 133 (SFAS 133), *Accounting for Derivative Instruments and Hedging Activities* , as amended. The Company generally utilizes non-deliverable forward contracts expiring within one to 24 months to reduce its foreign currency exposure due to exchange rate fluctuations on forecasted cash flows denominated in non-functional foreign currencies. Upon proper qualification, these contracts are accounted for as cash-flow hedges, as defined by SFAS 133. These contracts are entered into to protect against the risk that the eventual cash flows resulting from such transactions will be adversely affected by changes in exchange rates. In using derivative financial instruments to hedge exposures to changes in exchange rates, the Company exposes itself to counterparty credit risk.

All derivatives, including foreign currency forward contracts, are recognized in the balance sheet at fair value. On the date the derivative contract is entered into, the Company determines whether the derivative contract should be designated as a cash flow hedge. Changes in the fair value of derivatives that are highly effective and designated as cash flow hedges are recorded in Accumulated other comprehensive income (loss) , until the forecasted underlying transactions occur. Any realized gains or losses resulting from the cash flow hedges are recognized together with the hedged transaction within Revenues . Cash flows from the derivative contracts are classified within Cash flows from operating activities in the accompanying Condensed Consolidated Statement of Cash Flows. Ineffectiveness is measured based on the change in fair value of the forward contracts and the fair value of the hypothetical derivatives with terms that match the critical terms of the risk being hedged. Hedge ineffectiveness is recognized within Revenues .

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedging activities. This process includes linking all derivatives that are designated as cash flow hedges to forecasted transactions. The Company also formally assesses, both at the hedge s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items on a prospective and retrospective basis. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge or if a forecasted hedge is no longer probable of occurring, the Company discontinues hedge accounting prospectively. At March 31, 2009, all hedges were determined to be highly effective.

Table of Contents