SYKES ENTERPRISES INC
Form 10-Q
November 05, 2008

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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 September 30, 2008

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer or a smaller reporting company. See the definitions of accelerated filer , large 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 October 17, 2008, there were 41,255,428 outstanding shares of common stock.

Sykes Enterprises, Incorporated and Subsidiaries

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

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

(in thousands, except per share data)	September 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 220,051	$ 177,682
Receivables, net	157,641	145,490
Prepaid expenses	10,235	10,905
Other current assets	14,678	19,828
Short-term investments		17,827
Total current assets	402,605	371,732
Property and equipment, net	78,909	78,574
Goodwill, net	25,326	22,468
Intangibles, net	5,481	6,646
Deferred charges and other assets	32,810	26,055
	$ 545,131	$ 505,475
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 22,029	$ 21,588
Accrued employee compensation and benefits	48,024	46,245
Income taxes payable	9,492	4,592
Deferred revenue	32,219	31,822
Other accrued expenses and current liabilities	22,320	14,132
Total current liabilities	134,084	118,379
Deferred grants	9,493	10,329
Long-term income tax liabilities	5,126	6,269
Other long-term liabilities	7,942	5,177
Total liabilities	156,645	140,154
Commitments and loss contingency (Note 15)		

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; 41,268 and 45,537 shares issued		**413**		455
Additional paid-in capital		**157,022**		184,184
Retained earnings		**229,558**		195,203
Accumulated other comprehensive income		**2,117**		37,457
Treasury stock at cost: 60 shares and 4,697 shares		**(624)**		(51,978)
Total shareholders equity		**388,486**		365,321
	$	**545,131**	$	505,475

See accompanying notes to condensed consolidated financial statements.

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

(in thousands, except for per share data)	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Revenues	$ 207,066	$ 176,122	$ 618,416	$ 512,407
Operating expenses:				
Direct salaries and related costs	130,509	110,774	395,197	327,109
General and administrative	57,304	50,463	171,083	149,369
Total operating expenses	187,813	161,237	566,280	476,478
Income from operations	19,253	14,885	52,136	35,929
Other income (expense):				
Interest income	1,274	1,614	4,354	4,408
Interest (expense)	(47)	(230)	(274)	(538)
Other income (expense)	2,737	(233)	7,001	(1,190)
Total other income (expense)	3,964	1,151	11,081	2,680
Income before provision for income taxes	23,217	16,036	63,217	38,609
Provision for income taxes	3,725	3,780	10,286	8,217
Net income	$ 19,492	$ 12,256	$ 52,931	$ 30,392
Net income per share:				
Basic	$ 0.48	$ 0.30	$ 1.30	$ 0.75
Diluted	$ 0.47	$ 0.30	$ 1.29	$ 0.75
Weighted average shares:				
Basic	40,678	40,432	40,590	40,360
Diluted	41,070	40,697	40,928	40,624

See accompanying notes to condensed consolidated financial statements.

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Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Statements of Changes in Shareholders Equity
Nine Months Ended September 30, 2007, Three Months Ended December 31, 2007 and Nine Months Ended September 30, 2008
(Unaudited)

(In thousands)	Common Stock Shares Issued	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at January 1, 2007	45,254	$453	$179,021	$158,058	$ 5,869	$(51,928)	$291,473
Adjustment upon adoption of FIN 48				(2,714)			(2,714)
Issuance of common stock	67	1	450				451
Stock-based compensation expense			3,301				3,301
Issuance of common stock and restricted stock under equity award plans	195	1	26			(26)	1
Issuance of common stock for business acquisition	25		468				468
Comprehensive income				30,392	17,975		48,367
Balance at September 30, 2007	45,541	455	183,266	185,736	23,844	(51,954)	341,347
Issuance of common stock	3		23				23
Stock-based compensation expense			870				870
Issuance of common stock and restricted stock under equity award plans	(7)		25			(24)	1
Comprehensive income				9,467	13,613		23,080
Balance at December 31, 2007	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	**105**	**1**	**1,173**				**1,174**
Stock-based compensation expense			**3,554**				**3,554**
Issuance of common stock and restricted stock under equity award plans	**233**	**3**	**93**			**(132)**	**(36)**
Excess tax benefit from stock- based compensation			**688**				**688**
Retirement of treasury stock	**(4,644)**	**(46)**	**(33,346)**	**(18,094)**		**51,486**	
Issuance of common stock for business acquisition	**37**		**676**				**676**
Comprehensive income (loss)				**52,931**	**(35,340)**		**17,591**
Balance at September 30, 2008	**41,268**	**$413**	**$157,022**	**$229,558**	**$ 2,117**	**$ (624)**	**$388,486**

See accompanying notes to condensed consolidated financial statements.

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Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows
Nine months ended September 30, 2008 and 2007
(Unaudited)

(in thousands)	**2008**	2007
Cash flows from operating activities:		
Net income	**$ 52,931**	$ 30,392
Depreciation and amortization	**21,125**	18,315
Release of valuation allowance on deferred tax assets	**(6,121)**	
Unrealized foreign currency transaction gains, net	**(6,524)**	
Stock compensation expense	**3,554**	3,301
Excess tax benefit from stock-based compensation	**(688)**	
Deferred income tax provision (benefit)	**219**	(761)
Reversals of termination costs associated with exit activities		(60)
Foreign exchange loss (gain) on liquidation of foreign entities	**3**	(10)
Bad debt expense	**939**	137
Unrealized loss (gain) on financial instruments, net	**1,108**	(48)
Amortization of discount on short-term investments	**(173)**	
Amortization of actuarial gains on pension	**(49)**	
Changes in assets and liabilities:		
Receivables	**(17,679)**	(12,241)
Prepaid expenses	**(2,455)**	(3,552)
Other current assets	**369**	(3,381)
Deferred charges and other assets	**(759)**	982
Accounts payable	**1,789**	508
Income taxes receivable/payable	**1,600**	710
Accrued employee compensation and benefits	**3,984**	2,644
Other accrued expenses and current liabilities	**128**	(598)
Deferred revenue	**2,379**	(2,001)
Other long-term liabilities	**750**	876
Net cash provided by operating activities	**56,430**	35,213
Cash flows from investing activities:		
Capital expenditures	**(25,730)**	(22,761)
Proceeds from sale of property and equipment	**167**	80
Proceeds from release of restricted cash	**855**	1,600
Sale (purchase) of short-term investments	**17,535**	(17,535)
Purchase of long-term investments	**(997)**	
Investment in restricted cash		(393)
Cash paid for business acquisition	**(2,400)**	(1,600)
Other	**(130)**	(130)
Net cash used for investing activities	**(10,700)**	(40,739)
Cash flows from financing activities:		

Proceeds from issuance of stock	**1,174**	451
Excess tax benefit from stock-based compensation	**688**	
Net cash provided by financing activities	**1,862**	451
Effects of exchange rates on cash	**(5,223)**	13,521

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Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows
Nine months ended September 30, 2008 and 2007
(Unaudited)

(continued)

	2008	2007
Net increase in cash and cash equivalents	**42,369**	8,446
Cash and cash equivalents beginning	**177,682**	158,580
Cash and cash equivalents ending	**$ 220,051**	$ 167,026
Supplemental disclosures of cash flow information:		
Cash paid during period for interest	**$ 277**	$ 184
Cash paid during period for income taxes	**$ 13,702**	$ 8,909
Non-cash transactions:		
Property and equipment additions included in accounts payable	**$ 2,562**	$ 2,178

See accompanying notes to condensed consolidated financial statements

Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Nine months ended September 30, 2008 and 2007
(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, technology/consumer, financial services, healthcare, 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, 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 and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for any future quarters or the year ending December 31, 2008. 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, 2007, 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* . 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 September 30, 2008.

Short-Term Investments Short-term investments are investments that are highly liquid, held to maturity according to the provisions of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* , and have terms greater than three months, but less than one year, at the time of acquisition. As of December 31, 2007, the Company had short-term investments of $17.8 million in commercial paper (none as of September 30, 2008) with a remaining maturity of less than one year. Short-term investments are carried at amortized cost which approximates fair value. Therefore, there were no significant unrecognized holding gains or losses at December 31, 2007 or September 30, 2008.

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

Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Nine months ended September 30, 2008 and 2007
(Unaudited)

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

Goodwill (continued)

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 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. 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 Our Philippine operations are subject to Value Added Tax, or 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 receivable is approximately $7.2 million and $8.3 million as of September 30, 2008 and December 31, 2007, respectively, net of a valuation allowance of $2.1 million and $2.7 million, respectively. As of September 30, 2008 and December 31, 2007, the VAT receivables, net of the valuation allowance, of $5.5 million and $6.4 million, respectively, is included in Deferred Charges and Other Assets , $1.7 million and $0.0 million, respectively, is included in Other Current Assets and $0.0 million and $1.9 million, respectively, is included in Receivables in the accompanying Condensed Consolidated Financial Statements. We review our VAT receivable balance for impairment whenever events or changes in circumstances indicate the carrying amount might not be recoverable. During the three and nine months ended September 30, 2008, the Company determined that a portion of the VAT receivable balance was not recoverable and wrote down the balance by $0.1 million and $0.5 million, respectively. During the comparable 2007 periods, the Company wrote down the balance by $1.1 million and $1.3 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), which are discussed more fully in Note 13. 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 to satisfy stock option exercises or vesting of stock awards. The Company recognizes in its income statement 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.

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

Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Nine months ended September 30, 2008 and 2007
(Unaudited)

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

Foreign Currency Translation (continued)

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 expo