STARTEK INC
Form 10-Q
May 06, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2008

or

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 number 1-12793

StarTek, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**84-1370538**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. employer Identification No.)*
44 Cook Street, 4th Floor **Denver, Colorado**	**80206**
(Address of principal executive offices)	*(Zip code)*

(303) 262-4500
(Registrant s telephone number, including area code)

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	New York Stock Exchange, Inc.

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

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 þ 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 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 (Do not check if a smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock, $0.01 Par Value 14,735,791 shares as of April 15, 2008.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including the following:

- certain statements, including possible or assumed future results of operations, in Management s Discussion and Analysis of Financial Condition and Results of Operations;
- any statements contained herein regarding the prospects for our business or any of our services;
- any statements preceded by, followed by or that include the words may, will, should, seeks, believes, expects, anticipates, intends, continue, estimate, plans, future, targets, predicts, budgeted, outlooks, attempts, is scheduled, or similar expressions; and
- other statements contained herein regarding matters that are not historical facts.

Our business and results of operations are subject to risks and uncertainties, many of which are beyond our ability to control or predict. Because of these risks and uncertainties, actual results may differ materially from those expressed or implied by forward-looking statements, and investors are cautioned not to place undue reliance on such statements, which speak only as of the date thereof. Important factors that could cause actual results to differ materially from our expectations and may adversely affect our business and results of operations, include, but are not limited to those items set forth in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Risk Factors appearing in our Annual Report on Form 10-K for the year ended December 31, 2007.

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Part I. Financial Information

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

STARTEK, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations
(Dollars in thousands, except per share data)
(Unaudited)

	Three Months Ended March 31, 2008	2007
Revenue	$ 64,745	$ 57,647
Cost of services	55,162	48,737
Gross profit	9,583	8,910
Selling, general and administrative expenses	10,090	9,392
Restructuring charges	108	
Operating loss	(615)	(482)
Net interest and other income	310	188
Loss before income taxes	(305)	(294)
Income tax expense (benefit)	26	(105)
Net loss	$ (331)	$ (189)
Net loss per share:		
Basic	$ (0.02)	$ (0.01)
Diluted	$ (0.02)	$ (0.01)

See notes to condensed consolidated financial statements.

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STARTEK, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Dollars in thousands, except per share data)

	As of	
	March 31, 2008 (Unaudited)	**December 31, 2007**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,349	$ 23,026
Investments	16,667	16,349
Trade accounts receivable, less allowance for doubtful accounts of $0 and $0, respectively	56,497	48,887
Income tax receivable	1,609	2,502
Short-term deferred tax assets	120	165
Prepaid expenses and other current assets	1,739	2,243
Total current assets	91,981	93,172
Property, plant and equipment, net	56,999	57,532
Long-term deferred income tax assets	3,865	3,686
Other assets	966	1,068
Total assets	$ 153,811	$ 155,458
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,472	$ 5,908
Accrued liabilities:		
Accrued payroll	7,745	7,902
Accrued compensated absences	5,192	5,072
Other accrued liabilities	1,836	1,494
Amount outstanding on line of credit	1,672	
Current portion of long-term debt	3,586	3,975
Short-term deferred income tax liabilities	579	1,274
Other current liabilities	773	1,358
Total current liabilities	25,855	26,983
Long-term debt, less current portion	6,660	7,380
Long-term deferred rent liability	3,605	2,731
Other liabilities	141	150
Total liabilities	36,261	37,244

Commitments and contingencies		
Stockholders equity:		
Common stock, 32,000,000 non-convertible shares, $0.01 par value, authorized; 14,735,791 and 14,735,791 shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively	147	147
Additional paid-in capital	63,148	62,776
Cumulative translation adjustment	2,180	2,553
Unrealized loss on investments available for sale	(249)	(29)
Unrealized (loss) gain on derivative instruments	(92)	20
Retained earnings	52,416	52,747
Total stockholders equity	117,550	118,214
Total liabilities and stockholders equity	$ 153,811	$ 155,458

See notes to condensed consolidated financial statements.

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STARTEK, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Dollars in thousands)
(Unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Operating Activities		
Net loss	$ (331)	$ (189)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities		
Depreciation	4,400	4,227
Non-cash compensation cost	373	189
Deferred income taxes	(453)	(127)
Realized loss on investments		1
Loss on sale of assets	16	
Changes in operating assets and liabilities:		
Trade accounts receivable, net	(7,504)	(2,681)
Prepaid expenses and other assets	570	368
Accounts payable	(1,592)	(2,283)
Income taxes receivable, net	899	(531)
Accrued and other liabilities	638	1,151
Net cash (used in) provided by operating activities	(2,984)	125
Investing Activities		
Purchases of investments available for sale	(5,624)	(11,250)
Proceeds from disposition of investments available for sale	4,954	1,090
Purchases of property, plant and equipment	(3,946)	(2,567)
Net cash used in investing activities	(4,616)	(12,727)
Financing Activities		
Principal payments on borrowings	(1,308)	(1,381)
Principal payments on line of credit	(9,290)	(18,639)
Proceeds from line of credit	10,962	18,639
Principal payments on capital lease obligations	(11)	
Net cash provided by (used in) financing activities	353	(1,381)
Effect of exchange rate changes on cash	(430)	(77)
Net decrease in cash and cash equivalents	(7,677)	(14,060)
Cash and cash equivalents at beginning of period	23,026	33,437
Cash and cash equivalents at end of period	$ 15,349	$ 19,377

Supplemental Disclosure of Cash Flow Information				
Cash paid for interest	$	161	$	215
Income taxes paid	$	503	$	548
Unrealized loss on investments available for sale, net of tax	$	(220)	$	(14)
Property, plant and equipment acquired or refinanced under long-term debt	$	385	$	

See notes to condensed consolidated financial statements.

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STARTEK, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share data)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements reflect all adjustments (consisting only of normal recurring entries, except as noted) which, in the opinion of management, are necessary for fair presentation. Operating results during the three months ended March 31, 2008, are not necessarily indicative of operating results that may be expected during any other interim period of 2008 or the year ending December 31, 2008.

The consolidated balance sheet as of December 31, 2007, was derived from audited financial statements at that date, but does not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the StarTek, Inc. Annual Report on Form 10-K for the year ended December 31, 2007.

Certain reclassifications have been made to 2007 information to conform to 2008 presentation.

Unless otherwise noted in this report, any description of us refers to StarTek, Inc. and our subsidiaries. The assets and liabilities of our foreign operations that are recorded in foreign currencies are translated into U.S. dollars at exchange rates prevailing at the balance sheet date. Revenues and expenses are translated at the weighted-average exchange rate during the reporting period.

Fair Value of Financial Instruments

We measure or monitor many assets and liabilities on a fair value basis. Fair value is used on a recurring basis for assets and liabilities in which fair value is the primary basis of accounting. Examples of these include derivative instruments, cash and cash equivalents, and available for sale securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include long-lived assets. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

We adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157) as of January 1, 2008 and the effect of such adoption was not material to our results of operations or financial position. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The levels of the fair value hierarchy under SFAS No. 157 are described below:

Level 1	Valuation is based upon quoted prices for identical instruments traded in active markets
Level 2	Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market
Level 3	Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

When determining the fair value measurements for assets and liabilities required or permitted to be recorded at and/or marked to fair value, we consider the principal or most advantageous market in which it would transact and consider assumptions that market participants would use when pricing the asset or liability. When possible, we look to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, we look to market observable data for similar assets and liabilities. Nevertheless, if certain assets and liabilities are not actively traded in observable markets, we must use alternative valuation techniques to derive a fair value measurement.

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Recently Issued Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (SFAS No. 141R). SFAS No. 141R establishes principles and requirements for how an acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, (ii) recognizes and measures the goodwill acquired in a business combination or a gain from a bargain purchase, and (iii) determines what information to disclose to enable users of financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R will be applied prospectively to business combinations that have an acquisition date on or after January 1, 2009. The provisions of SFAS No. 141R will not impact our Condensed Consolidated Financial Statements for prior periods.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS No. 133 (SFAS No. 161). This statement will require additional disclosures about how and why we use derivative financial instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , as amended and interpreted (SFAS No. 133), and how derivative instruments and related hedged items affect our financial position, results of operations, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008; however early adoption is encouraged, as are comparative disclosures for earlier periods. We are currently evaluating the impact of adopting SFAS No. 161.

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2. RESTRUCTURING CHARGES

In August 2007, we closed our facility in Hawkesbury, Ontario, Canada. We have recorded restructuring charges related to lease costs, telephony disconnects and other expenses related to the facility closure. In accordance with Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS No. 146), we recognized the liability when it was incurred, instead of upon commitment to a plan. The following table summarizes our restructuring accrual and related activity during the period:

	Facility-Related Costs	
Balance as of January 1, 2008	$	502
Expense		108
Payments		(219)
Balance as of March 31, 2008	$	391

This restructuring accrual has been included in Other Accrued Liabilities in the accompanying Condensed Consolidated Balance Sheets. A significant assumption used in determining the amount of estimated liability for closing sites is the estimated liability for future lease payments on vacant facilities. If the assumptions regarding early termination and the timing and amounts of sublease payments prove to be inaccurate, we may be required to record additional losses, or conversely, a future gain, in our Condensed Consolidated Statements of Operations.

3. NET LOSS PER SHARE

Basic and diluted net loss per common share is computed on the basis of our weighted average number of common shares outstanding, as determined by using the calculations outlined below:

	Three Months Ended March 31,			
	2008		2007	
Net loss	$	(331)	$	(189)
Weighted average shares of common stock		14,705		14,695
Dilutive effect of stock options				
Common stock and common stock equivalents		14,705		14,695
Net loss per basic share	$	(0.02)	$	(0.01)
Net loss per diluted share	$	(0.02)	$	(0.01)

Diluted earnings per share is computed on the basis of our weighted average number of common shares outstanding plus the effect of dilutive outstanding stock options and non-vested restricted stock using the treasury stock method. Anti-dilutive securities totaling 1,638 and 757 in the three months ended March 31, 2008, and 2007, respectively, were not included in our calculation because the stock options exercise prices were greater than the average market price of the common shares during the periods presented.

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4. PRINCIPAL CLIENTS

The following table represents revenue concentration of our principal clients.

	Three Months Ended March 31,	
	2008	2007
AT&T, Inc.	49.4%	53.0%
T-Mobile, a subsidiary of Deutsche Telekom	27.8%	19.5%

A significant portion of our contract with AT&T Mobility LLC (the AT&T Contract), a wholly-owned subsidiary of AT&T, Inc. (AT&T), including the customer care and accounts receivable management portions of the contract (the Customer Care Services), has been extended through May 30, 2008 as the parties negotiate a new agreement for the Customer Care Services. The remaining portion of the AT&T Contract, comprising business care services, was replaced in December 2006 with a contract that expires in November 2008. We entered into a services agreement and statement of work with T-Mobile for the provision of certain call center services, each being effective October 1, 2007 and continuing for two years. That agreement and statement of work were included as Exhibit 10.12 in the Quarterly Report on Form 10-Q that we filed with the SEC on November 6, 2007.

The loss of a principal client and/or changes in timing or termination of a principal client s product launch, volume delivery or service offering would have a material adverse effect on our business, revenue, operating results, and financial condition. To limit our credit risk, management from time to time will perform credit evaluations of our clients. Although we are directly impacted by the economic conditions in which our clients operate, management does not believe substantial credit risk existed as of March 31, 2008.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

Our financial instruments consist of cash and cash equivalents, investments, trade accounts receivable, accounts payable, derivative instruments, a line of credit and long-term debt. Carrying values of cash and cash equivalents, trade accounts receivable, and accounts payable approximate fair value due to the short term nature of these accounts. Investments and derivative instruments are reported at fair value. Management believes differences between the fair value and the carrying value of lines of credit and long-term debt is not material because interest rates approximate market rates for material items. As discussed in Note 1, Basis of Presentation , effective January 1, 2008, we adopted SFAS No. 157 and SFAS No. 159. In our adoption of SFAS No. 159, we did not identify any assets or liabilities, previously recorded at other than fair value, which we determined to begin measuring at fair value.

The following table summarizes our financial instruments measured at fair value as of March 31, 2008 and December 31, 2007.

	As of			
	March 31, 2008		December 31, 2007	
	Assets	Liabilities	Assets	Liabilities
Cash and cash equivalents	$ 15,349	$	$ 23,026	$
Investments	16,667		16,349	
Derivative instruments		151	27	
Total	$ 32,016	$ 151	$ 39,402	$

Cash and Cash Equivalents

We consider cash equivalents to be short-term, highly liquid investments readily convertible to known amounts of cash and so near their maturity they present insignificant risk of changes in value because of changes in interest rates. As of March 31, 2008, included in cash and cash equivalents was commercial paper with a fair value of $11,951 and corporate debt securities with a fair value of $100. As of December 31, 2007, included in cash and cash equivalents was commercial paper with a fair value of $13,079. Commercial paper and corporate debt securities included in cash and cash equivalents as of March 31, 2008 and December 31, 2007 are short-term, highly liquid and have maturities of less than three months.

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Investments

As of March 31, 2008, investments available for sale consisted of:

	Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Commercial paper	$ 2,880	$	$	$ 2,880
Corporate debt securities	13,859	11	(385)	13,485
Mortgage backed securities	301	1		302
	$ 17,040	$ 12	$ (385)	$ 16,667

As of December 31, 2007, investments available for sale consisted of corporate debt securities with a basis of $16,412, gross unrealized gains of $59, gross unrealized losses of $122, and a fair value of $16,349. As of March 31, 2008, the basis of the investments in our portfolio have remaining contractual maturities as follows: $15,250 within one year, $1,489 in one to two years and $301 in two to three years. We had no investments at March 31, 2008 or December 31, 2007, that had carried unrealized losses for longer than twelve months. Because we have the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Our corporate debt securities, mortgage backed securities and commercial paper are valued using third party broker statements. The value of the majority of our corporate debt securities and mortgage backed securities is derived from quoted market information. The inputs to the valuation are generally classified as Level 1 given the active market for these securities, however, if an active market does not exist, the inputs are recorded at a lower level in the fair value hierarchy. The value of commercial paper is derived from pricing models using inputs based upon market information, including face value, contractual terms and interest rates.

Derivative Instruments and Hedging Activities

We enter into foreign exchange contracts to hedge our anticipated operating commitments that are denominated in foreign currencies. The contracts cover periods commensurate with expected exposure, generally within six months, and are principally unsecured foreign exchange contracts. The market risk exposure is essentially limited to risk related to currency rate movements. During the three months ended March 31, 2008 and 2007, these hedging commitments resulted in unrealized losses, net of tax, of $112 and unrealized gains, net of tax, of $237, respectively, which have been recorded in other comprehensive income. These hedging commitments resulted in a net realized loss of $208 during the three months ended March 31, 2008. The realized loss was recognized in cost of services in our Condensed Consolidated Statements of Operations. There was no realized gain or loss during the three months ended March 31, 2007.

Our derivative instruments are valued using third party broker or counterparty statements. The value is derived from pricing models using inputs based upon market information, including contractual terms, market prices and yield curves.

Fair Value Hierarchy

The following table sets forth our financial instruments by level within the fair value hierarchy. As required by SFAS No. 157, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	Assets and Liabilities at Fair Value as of March 31, 2008			
	Level 1	Level 2	Level 3	Total
Financial assets:				
Commercial paper	$	$ 14,831	$	$ 14,831
Corporate debt securities	13,485	100		13,585
Mortgage backed securities	302			302

Total financial assets	$	13,787	$	14,931	$		$	28,718
Financial liabilities:								
Derivative instruments				151				151
Total financial liabilities	$		$	151	$		$	151

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6. COMPREHENSIVE (LOSS) INCOME

Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income, establishes standards for reporting and display of comprehensive income. Comprehensive income is defined essentially as all changes in stockholders equity, exclusive of transactions with owners. The following represents the components of other comprehensive (loss) income:

	Three Months Ended March 31,	
	2008	2007
Net loss	$ (331)	$ (189)
Other comprehensive (loss) income:		
Foreign currency translation adjustments, net of tax	(373)	124
Change in fair value of derivative instruments, net of tax	(112)	237
Unrealized loss on available for sale securities, net of tax	(220)	(14)
Comprehensive (loss) income	$ (1,036)	$ 158

7. SHARE-BASED COMPENSATION

We maintain two equity compensation plans, the StarTek, Inc. Stock Option Plan and the Directors Option Plan (together, the Plans), for the benefit of certain of our directors, officers and employees. The compensation cost that has b