APAC CUSTOMER SERVICES, INC
Form 10-Q
August 11, 2010

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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 July 4, 2010

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: 0-26786

APAC Customer Services, Inc.

(Exact name of registrant as specified in its charter)

Illinois	**36-2777140**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Bannockburn Lake Office Plaza 1, 2333 Waukegan Road, Suite 100, Bannockburn, Illinois 60015

(Address of Principal Executive Offices, Zip Code)

Registrant s telephone number, including area code: **(847) 374-4980**

Indicate by check mark whether 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 periods 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes 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).

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 Rule 12b-2 of the Exchange Act).

Yes o No þ

There were 52,642,438 common shares, $0.01 par value per share, outstanding as of August 6, 2010.

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Forward-Looking Statements and Factors That May Affect Future Results

In passing the Private Securities Litigation Reform Act of 1995 (the Reform Act), Congress encouraged public companies to make forward-looking statements by creating a safe harbor to protect companies from securities law liability in connection with forward-looking statements. We intend to qualify our written and oral forward-looking statements for protection under the Reform Act and any other similar safe harbor provisions. Unless the context indicates otherwise, the words Company, we, our, and us when used in this Quarterly Report on Form 10-Q r collectively to APAC Customer Services, Inc. and its wholly-owned subsidiaries.

Generally, forward-looking statements include expressed expectations, estimates and projections of future events and financial performance and the assumptions on which these expressed expectations, estimates and projections are based. Statements that are not historical facts, including statements about our beliefs and expectations and those of our management, are forward-looking statements. Sometimes these statements will contain words such as believes, expects, anticipates, intends, estimates, goals, would, could, should, plans, and other si forward-looking statements are inherently uncertain as they are based on various expectations and assumptions about future events, and they are subject to known and unknown risks and uncertainties that can cause actual events and results to differ materially from historic results and those projected.

Due to such uncertainties, the investment community is cautioned not to place undue reliance on our written or oral forward-looking statements, which speak only as of the date on which they were made. If no date is provided, such statements speak only as of the date of this Quarterly Report on Form 10-Q. We expressly undertake no obligation to publicly update or revise any forward-looking statements as a result of changed assumptions, new information, future events or otherwise.

Forward-looking statements are contained in this Quarterly Report on Form 10-Q, primarily in Items 2 and 3. Moreover, through our senior management, we may from time to time make forward-looking statements about matters described herein or about other matters concerning us.

There are numerous factors that could prevent us from achieving our goals and cause future results to differ materially from historic results or those expressed or implied by forward-looking statements including, but not limited to, the following:

- A large portion of our revenue is generated from a limited number of clients and the loss of one or more of them, or a reduction in their demand for our services, could materially affect our financial results.
- Our operating results and financial condition may be affected by the performance of our clients and unfavorable general economic conditions.
- The failure to effectively manage our production capacity and our workforce could negatively impact our financial results.
- Our success is subject to the terms of our client contracts and if we are unable to continue operating under existing client contracts or renew existing client contracts with terms favorable to the Company, our results of operations and financial condition may be adversely affected by the loss of clients or by the less favorable terms.
- Our business may be affected by our cash flows from operations and our ability to comply with our debt covenants and funding requirements under our credit facility.
- Our financial results may be affected by risks associated with international operations and expansion, including, but not limited to foreign currency fluctuations and changes to laws in other countries.
- Our principal shareholder can exercise significant control over the Company and, as a result of such control may be able to exert considerable influence over our future direction and operations.
- Our success depends on our ability to recruit and retain a sufficient number of qualified key personnel and the loss of the services of key personnel without adequate replacement or the inability to attract new qualified personnel could have a material adverse effect on us.

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- We operate in a highly competitive industry and our financial results may suffer if we are unable to adequately address potential downward pricing pressures and other competitive factors.
- Circumstances outside our control such as typhoons, hurricanes, earthquakes, floods and other acts of God, political instability, equipment malfunction, telephone or data service interruptions, changes in the telecommunications market, war and terrorism could seriously harm our domestic or international business operations.
- Unauthorized disclosure of sensitive or confidential client and customer data could expose us to protracted and costly litigation, penalties and may cause us to lose clients.
- Our business and our clients businesses are subject to federal and state regulation and industry standards and the costs of compliance with, or liability for violation of, existing or future regulations or standards could significantly increase our costs of doing business.
- The costs and management time and attention associated with litigation could result in a negative impact to financial results.
- Our business is subject to rapid changes in technology and if our technology is rendered obsolete or we are unable to compete effectively, our operating results and financial condition could be materially and adversely affected.
- Volatility in our stock price may result in loss of investment for shareholders as well as litigation, substantial cost and diversion of management s attention.

See our filings with the Securities and Exchange Commission (SEC) for further discussion of the risks and uncertainties associated with our business, in particular, the discussion in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010, and in Item 1A of Part II of this Quarterly Report on Form 10-Q.

In various places throughout this Quarterly Report on Form 10-Q we use certain non-GAAP financial measures when describing our performance. A non-GAAP financial measure is defined as a numerical measure of a company s financial performance that excludes or includes amounts so as to be different than the most directly comparable measure calculated and presented in accordance with GAAP in the statements of operations, balance sheets or statements of cash flows of a company. We believe that non-GAAP financial measures provide meaningful supplemental information and are useful in understanding our results of operations and analyzing of trends because they exclude certain charges such as interest, taxes and depreciation and amortization expenses that are not part of our ordinary business operations. We also believe that non-GAAP financial measures are useful to investors and analysts in allowing for greater transparency with respect to the supplemental information used by us in our financial and operational decision-making. In addition, we believe investors, analysts and lenders benefit from referring to non-GAAP measures when assessing our performance and expectations of our future performance. However, this information should not be used as a substitute for our GAAP financial information; rather it should be used in conjunction with financial statement information contained in our Condensed Consolidated Financial Statements prepared in accordance with GAAP. We discuss non-GAAP financial measures in Item 2 of this Quarterly Report on Form 10-Q under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations Non-GAAP Financial Measures. Pursuant to the requirements of Regulation G, we have provided a reconciliation of all non-GAAP financial measures to the most directly comparable GAAP financial measure in Item 2 of this Quarterly Report on Form 10-Q.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	July 4, 2010 (Unaudited)	January 3, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 45,416	$ 20,557
Accounts receivable, net	36,540	45,358
Deferred tax assets, current	9,045	14,593
Other current assets	8,508	6,323
Total current assets	99,509	86,831
Property and equipment, net	24,796	25,653
Goodwill	13,338	13,338
Other intangible assets, net	147	1,028
Deferred tax assets, non-current	10,170	10,170
Other assets	1,742	1,585
Total assets	$ 149,702	$ 138,605
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Capital leases current portion	$ 505	$ 397
Accounts payable	2,395	2,770
Income taxes payable		365
Accrued payroll and related items	20,227	21,964
Accrued liabilities	10,384	9,190
Total current liabilities	33,511	34,686
Other non-current liabilities	3,170	4,171
Commitments and contingencies		
Shareholders equity:		
Common shares, $0.01 per share; authorized 200,000,000 shares; 52,642,438 shares issued and outstanding at July 4, 2010, and 52,318,726 shares issued and outstanding at January 3, 2010	526	523
Additional paid-in capital	111,542	109,818
Accumulated earnings (deficit)	201	(11,688)
Accumulated other comprehensive income	752	1,095
Total shareholders equity	113,021	99,748

Total liabilities and shareholders equity	$ 149,702	$ 138,605

See Notes to Condensed Consolidated Financial Statements.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share data)
(Unaudited)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
Net revenue	$ 77,386	$ 66,042	$ 162,640	$ 139,288
Cost of services	61,009	50,638	125,817	105,334
Gross profit	16,377	15,404	36,823	33,954
Operating expenses:				
Selling, general and administrative expenses	8,103	7,603	16,250	15,297
Legal settlement	7		2,407	4
Total operating expenses	8,110	7,603	18,657	15,301
Operating income	8,267	7,801	18,166	18,653
Other (income) expense	139	(23)	30	(30)
Interest (income) expense	(7)	(47)	(15)	42
Income before income taxes	8,135	7,871	18,151	18,641
Income tax expense	2,806	135	6,262	286
Net income	$ 5,329	$ 7,736	$ 11,889	$ 18,355
Net income per share:				
Basic	$ 0.10	$ 0.15	$ 0.23	$ 0.36
Diluted	$ 0.10	$ 0.14	$ 0.22	$ 0.34
Weighted average number of shares outstanding:				
Basic	52,476	51,404	52,393	51,111
Diluted	54,831	54,567	54,745	53,241

See Notes to Condensed Consolidated Financial Statements.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Twenty-Six Weeks Ended	
	July 4, 2010	June 28, 2009
Operating activities:		
Net income	$ 11,889	$ 18,355
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,071	5,782
Deferred income taxes	5,548	
Stock compensation expense	1,195	219
Amortized gain on sale leaseback	(52)	(47)
Gain on sale of property and equipment	(1)	(1)
Income taxes payable	(365)	283
Change in operating assets and liabilities	4,676	(6,473)
Net cash provided by operating activities	28,961	18,118
Investing activities:		
Purchases of property and equipment, net	(3,968)	(5,467)
Net proceeds from sale of property and equipment	1	1
Net cash used in investing activities	(3,967)	(5,466)
Financing activities:		
Net payments under revolving credit facility		(6,100)
Payment of capital lease obligations	(332)	(16)
Stock option transactions, including related excess income tax benefits	533	1,771
Net cash provided by (used in) financing activities	201	(4,345)
Effect of exchange rate change on cash	(336)	680
Net increase in cash and cash equivalents	24,859	8,987
Cash and cash equivalents:		
Beginning balance	20,557	618
Ending balance	$ 45,416	$ 9,605

See Notes to Condensed Consolidated Financial Statements.

APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share data)

1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements of APAC Customer Services, Inc. and its subsidiaries (collectively, the Company) have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring nature) considered necessary for a fair presentation have been included. Interim consolidated financial statements are not necessarily indicative of the financial position or operating results for an entire year.

The Company s international customer care centers use their local currency, the Philippine peso and the Dominican peso, as their functional currency. Assets and liabilities of international customer care centers have been translated at period-end rates, and income and expenses have been translated using average exchange rates for the respective periods. All inter-company transactions and balances have been eliminated. The balance sheet at July 4, 2010 has been derived from the unaudited financial statements at that date and includes all of the information and notes required by GAAP for interim financial statements. These interim financial statements should be read in conjunction with the audited financial statements and notes thereto included in Item 8 of Part II of the Company s Annual Report on Form 10-K for the fiscal year ended January 3, 2010. Copies of the Company s filings are available on a web site maintained by the SEC at http://www.sec.gov.

The Company operates on a thirteen week fiscal quarter that ends on the Sunday closest to June 30. The Company operates on a 52/53 week fiscal year that ends on the Sunday closest to December 31.

2. New Accounting Pronouncements

Fair Value

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance amending Accounting Standards Codification (ASC) Topic 820 *Fair Value Measurements and Disclosures* . ASC Sub-topic 820-10 and related guidance was amended to require disclosure of the transfers in and out of Levels 1 and 2 and a schedule for Level 3 that separately identifies purchases, sales, issuances and settlements and requires more detailed disclosures regarding valuation techniques and inputs. This update is effective for interim and annual reporting periods beginning after December 15, 2009 except for the disclosures about purchases, sales issuances and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this guidance effective January 4, 2010, the beginning of the Company s current fiscal year, did not have a material impact on the Company s condensed consolidated financial statements. See Note 11 for disclosures associated with the adoption of this guidance.

Revenue Recognition

In October 2009, the FASB issued guidance on ASC Topic 605 *Revenue Recognition* related to revenue arrangements with multiple deliverables, which revises the criteria for separating, measuring, and allocating arrangement consideration to each deliverable in a multiple element arrangement. The guidance requires companies to allocate revenue using the relative selling price of each deliverable, which must be estimated if the Company does not have a history of selling the deliverable on a stand-alone basis or third-party evidence of selling price. This guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company s condensed consolidated financial statements.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share data)

Subsequent Events

In February 2010, the FASB issued guidance amending Topic 855 *Subsequent Events* , to clarify that while SEC filers are required to evaluate subsequent events through the date financial statements are issued, they will not be required to disclose the date through which subsequent events have been evaluated. This guidance is effective as of February 24, 2010. The Company adopted this guidance during the fiscal quarter ended April 4, 2010. The adoption did not have a material impact on the Company s condensed consolidated financial statements. See Note 14 for disclosures associated with the adoption of this guidance.

3. Accrued Liabilities

The components of other current accrued liabilities included in the condensed consolidated balance sheets are as follows:

	July 4, 2010	January 3, 2010
Accrued legal settlement	$ 2,400	$
Non-qualified retirement plan liability	1,981	1,931
Deferred rent	1,012	1,134
Accrued professional fees	858	719
Accrued temporary labor	674	839
Accrued workers compensation	582	929
Accrued telecommunications expense	537	961
Accrued capital expenditures	253	890
Other accrued liabilities	2,087	1,787
Total	$ 10,384	$ 9,190

4. Goodwill and Other Intangible Assets

There were no significant changes in goodwill for the twenty-six weeks ended July 4, 2010. As of July 4, 2010 and January 3, 2010, the Company had $13.3 million of goodwill.

The identifiable intangible assets of the Company include acquired customer relationships and internally developed software. The acquired customer relationships have a gross carrying value of $28.5 million and accumulated amortization of $28.5 million and $27.6 million as of July 4, 2010 and January 3, 2010, respectively. The acquired customer relationships have been fully amortized as of July 4, 2010. The internally developed software has a gross carrying value of $0.4 million and $0.3 million as of July 4, 2010 and January 3, 2010, respectively, and accumulated amortization of $0.2 million as of July 4, 2010 and January 3, 2010. Total amortization expense related to intangible assets was $0.3 million and $0.6 million for the thirteen weeks ended July 4, 2010 and June 28, 2009, respectively, and $0.9 million and $1.2 million for the twenty-six weeks ended July 4, 2010 and June 28, 2009, respectively.

5. Accounting for Stock-Based Compensation

The Company has a share-based incentive compensation plan for employees and non-employee directors, which authorizes the granting of various equity-based incentive awards, including stock options and non-vested common shares. The total number of common shares authorized for issuance under the plan is 11.8 million, of which 1.2 million shares are available for future grants at July 4, 2010.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share data)

Total stock-based compensation expense was $0.7 million and $0.2 million for the thirteen weeks ended July 4, 2010 and June 28, 2009, respectively. For the twenty-six weeks ended July 4, 2010 and June 28, 2009, total stock-based compensation expense was $1.2 million and $0.2 million, respectively. As of July 4, 2010, there was $3.7 million of unrecognized compensation cost related to unvested awards that is expected to be recognized over a weighted-average period of approximately 3.2 years.

A summary of the Company s non-vested common share grant activity during the twenty-six weeks ended July 4, 2010 is presented below:

	Number of Shares
Outstanding on January 3, 2010	25,000
Granted	
Issued	(25,000)
Forfeited	
Expired	
Outstanding on July 4, 2010	

The Company did not award non-vested common shares during the twenty-six weeks ended July 4, 2010 and June 28, 2009.

A summary of the Company s stock option grant activity during the twenty-six weeks ended July 4, 2010 is presented below:

	Number of Options	Grant Price Range Per Share				Weighted Average Exercise Price Per Share		Aggregate Intrinsic Value	
Outstanding on January 3, 2010	6,136,677	$	0.79	$	11.63	$	2.24		
Granted	482,440		5.68		5.96		5.80		
Exercised	(323,712)		1.06		3.57		1.65		
Forfeited	(3,500)		5.31		5.31		5.31		
Expired	(18,000)		2.81		11.63		10.20		
Outstanding on July 4, 2010	6,273,905	$	0.79	$	7.36	$	2.52	$	19,542
Exercisable on July 4, 2010	3,161,719	$	0.79	$	7.36	$	2.17	$	10,908

Substantially all of the options become exercisable between one to five years after the grant date and generally expire ten years from the grant date.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share data)

6. Comprehensive Income

Comprehensive income for the thirteen and twenty-six weeks ended July 4, 2010 and June 28, 2009 is as follows:

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
Net income	$ 5,329	$ 7,736	$ 11,889	$ 18,355
Foreign currency translation adjustment	(167)	19	23	(104)
Unrealized gain on derivative contracts	(636)	257	(366)	614
Total comprehensive income	$ 4,526	$ 8,012	$ 11,546	$ 18,865

7. Legal Proceedings

On May 27, 2009, a purported collective/class action complaint captioned Tiffany Sharpe, et al. v. APAC Customer Services, Inc. was filed in the United States District Court for the Western District of Wisconsin. On behalf of the named plaintiff, a non-exempt call center employee, and other similarly situated individuals, the complaint asserted violations under the Federal Fair Labor Standards Act (FLSA) related to overtime compensation and wage records. The complaint also asserted violations under Wisconsin Wage Payment and Overtime Compensation Laws based upon the same alleged facts. The complaint purported to allege claims as a nationwide collective action under federal law, as well as a class action under Wisconsin state law. The complaint sought various forms of relief, including injunctive relief, unpaid overtime wages, liquidated damages, interest, and attorneys fees and costs. On January 8, 2010, the court entered an order which conditionally certified the case as a collective action under the FLSA.

In March 2010, the Company entered into an agreement to resolve the collective action. On June 16, 2010, the Court entered an order approving the resolution of all claims under the FLSA collective action. Under the terms of the agreement, the Company agreed to pay a maximum amount of $4.0 million to resolve claims by eligible class members, including payments to class members and payments for plaintiff attorneys fees. As a result, the Company recorded a charge of $2.4 million for the thirteen weeks ended April 4, 2010 which represents its estimate of the costs to be incurred for attorneys fees and claims, based on expected opt-in rates for claimants in similar actions. The final amount which will ultimately be paid by the Company under the agreement will be determined based on the participation from eligible class members as well as the Court s final ruling with respect to plaintiff attorneys fees.

The Company denied and continues to deny the allegations in the complaint and contends that its policies and practices regarding compensation were proper and in compliance with the law at all times. The Company denies all liability and wrongdoing in this case, but has chosen to settle this lawsuit in order to avoid the distraction and additional legal expenses that would otherwise be incurred.

The Company is subject to other lawsuits, claims and governmental investigations arising out of the normal conduct of its business. Management does not believe that the outcome of any pending proceedings will have a material adverse effect on the Company s business, results of operations, liquidity, or financial condition. Although management does not believe that any such proceeding will result in a material adverse effect, no assurance to that effect can be given.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share data)

8. Debt

As of July 4, 2010, there were no outstanding borrowings under the Revolving Loan Agreement and the Company had cash and cash equivalents of $45.4 million.

As of January 4, 2010, the Company was party to a Revolving Credit and Security Agreement, as amended, (Revolving Loan Agreement) with PNC Bank National Association (PNC), as agent, and the financial institutions from time to time parties thereto as lenders. The Revolving Loan Agreement provides the Company with a $40.0 million revolving loan facility which expires in May 2011.

The Company s ability to borrow under the Revolving Loan Agreement depends on the amount of eligible accounts receivable from its clients. The Revolving Loan Agreement contains certain financial covenants including limits on the amount of capital expenditures and maintenance of a minimum fixed charge coverage ratio. Other covenants in the Revolving Loan Agreement prohibit (with limited exceptions) the Company from incurring additional indebtedness, repurchasing outstanding common shares, permitting liens, acquiring, selling or disposing of certain assets, engaging in certain mergers and acquisitions, paying dividends or making certain restricted payments.

Borrowings under the Revolving Loan Agreement incur a floating interest rate based on the LIBOR index rate or an alternate base rate which approximates the prime rate defined in the Revolving Loan Agreement subjecting the Company to interest rate risk and required a $5.0 million interest rate hedge. In August 2008, the Company entered into a pay fixed / receive floating interest rate swap for a $5.0 million notional amount. The objective of the swap was to mitigate the variability in cash flows resulting from changes in the LIBOR rate. In June 2009, the swap was terminated due to the elimination of all outstanding borrowings.

The Revolving Loan Agreement is secured principally by a grant of a first priority security interest in all of the Company s personal property, including its accounts receivable. In addition, the Company pays a commitment fee on the unused portion of the Revolving Loan Agreement as well as fees on outstanding letters of credit.

The Company was in compliance with its financial covenants related to the Revolving Loan Agreement as of July 4, 2010.

9. Income Taxes

The Company accounts for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is recorded when management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized in the future. The Company records a reserve for tax contingencies unless it believes it is more likely than not that the deductions giving rise to these contingencies will be sustained if challenged by taxing authorities. Tax contingencies are not material to the financial statements.

Income tax expense for the thirteen and twenty-six weeks ended July 4, 2010 was $2.8 million and $6.3 million, respectively. This results in a 34.5% effective income tax rate for the thirteen and twenty-six weeks ended July 4, 2010, which is lower than the statutory rate due to the generation of tax credits. Income tax expense for the thirteen and twenty-six weeks ended June 28, 2009, was $0.1 million and $0.3 million, respectively. This was driven by a gross income earned tax of 5% on a portion of our Philippine financial results and certain state income taxes on our domestic financial results. The federal tax provision for the thirteen and twenty-six weeks ended June 28, 2009 was fully offset by the utilization of net operating loss carryforwards and work opportunity tax credits. This resulted in a 1.7% effective tax rate for the thirteen weeks ended June 28, 2009 and a 1.5% effective income tax rate for the twenty-six weeks ended June 28, 2009.

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APAC CUSTOMER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollars in thousands, except per share data)

10. Earnings Per Share

Basic earnings per share are computed by dividing the Company s net income by the weighted average number of common shares outstanding. Diluted earnings per share are computed by dividing the Company s net income by the weighted average number of shares and dilutive potential common shares outstanding during the period. The following table sets forth the computation of basic and diluted earnings per share for the thirteen and twenty-six weeks ended July 4, 2010 and June 28, 2009:

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
	(In thousands, except earnings per share)			
Net income	$ 5,329	$ 7,736	$ 11,889	$ 18,355
Shares used in basic per share calculation	52,476	51,404	52,393	51,111
Effects of dilutive securities:				
Stock options	2,355	3,138	2,348	2,105
Non-vested stock		25	4	25
Shares used in diluted per share calculation	54,831	54,567	54,745	53,241
Net income per share:				
Basic	$ 0.10	$ 0.15	$ 0.23	$ 0.36
Diluted	$ 0.10	$ 0.14	$ 0.22	$ 0.34

11. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The accounting standards establish a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly.

Level 3 Unobservable inputs based on the Company s own assumptions.

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of July 4, 2010:

	Fair Value Measurements as of July 4, 2010		
	Level 1	Level 2	Level 3
Assets:			
Cash equivalents(1)	$ 35,773	$	$
Non-qualified retirement plan(2)	1,981		
Foreign currency derivative contracts(3)		163	

Non-current investments(4)	126		
Liabilities:			
Foreign currency contracts(3)	$	$ 160	$
Non-qualified retirement plan obligation(2)	1,981		

(1) Cash equivalents: The carrying amount of these items approximates fair value at period end.

(2) Non-qualified retirement plan: The Company maintains a non-qualified retirement plan (Select Plan) for highly compensated employees who are limited in the amount of contributions that they can make in the Company s 401-K plan. As of July 4, 2010, the fair value of investments in the Select Plan totaled $2.0 million and is reflected on the Company s balance sheet in other current assets. The related obligation to employees participating in the Select Plan, which will always equal the fair value of the investments, are

recorded on the Company s balance sheet in other current liabilities.

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(Unaudited)
(Dollars in thousands, except per share data)

(3) Foreign currency derivative contracts: The carrying amount of these items is based on valuations provided by the counter-party institution, but there are no guaranteed selling prices for these forward currency contracts.

(4) Non-current investments: The carrying amount of these items, which represent Philippine treasury bills, approximates fair value at as of July 4, 2010 and is recorded as a component of other assets on the Company s balance sheet.

The carrying amounts of accounts receivable, accounts payable and short-term debt approximate fair value.

There were no transfers of assets or liabilities between Level 1 and Level 2 during the thirteen and twenty-six weeks ended July 4, 2010.

12. Derivative Instruments

The Company uses forward contracts to mitigate foreign currency risk and had used an interest rate swap to mitigate interest rate risk. The Company s derivatives are designated as cash flow hedges to the extent that the instruments qualify for accounting as a hedging instrument; therefore, the effective portion of gains and losses that result from changes in fair value of the derivative instruments are recorded in accumulated other comprehensive income

(OCI) until the hedged transaction affects income, at which time gains and/or losses are realized. The Company expects these amounts to be reclassified into earnings over the next eighteen months. If the instrument does not qualify for accounting as a hedge, the change in the value of the instrument during the reporting period is recorded immediately to earnings. The Company assesses hedge effectiveness each reporting period.

The objective of the foreign currency hedge contract is to mitigate the variability in cash flows and expenses over the period of the hedge contracts due to the foreign currency risk associated with the repayment of the intercompany accounts payable from the U.S. operations to the Philippines representing the Philippines share of revenue. The Company currently engages in forward contracts with two major financial credit institutions. Forward contracts to purchase approximately 1,017 million Philippine pesos at a U.S. dollar notional of $21.5 million were outstanding as of July 4, 2010.

Each contract is designated to a hedged item which is settled periodically. The hedged item represents the change in the U.S. dollar cash flow necessary to settle the accounts payable balance at periodic intervals over the next 18 months. The settlement timing corresponds with the payroll and rent cycles in the Philippines. No ineffectiveness is anticipated because the notional amount of the contracts is no more than 95% of the anticipated payable balance and declines steadily over the course of the next eighteen months. Also, the maturity date of the forward contract coincides with the timing of the effective repayment of the intercompany payable.

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At July 4, 2010 and January 3, 2010, the fair value carrying amount of the Company s derivative instruments was recorded as follows:

	Asset Derivatives		
		Fair Value	
	Balance Sheet Location	July 4, 2010	January 3, 2010
Derivatives designated as hedging instruments:			
Foreign currency contracts	Other Current Assets	$ 163	$ 657
Total derivatives		$ 163	$ 657

	Liability Derivatives		
		Fair Value	
	Balance Sheet Location	July 4, 2010	January 3, 2010
Derivatives designated as hedging instruments:			
Foreign currency contracts	Accrued Liabilities	$ 160	$ 15
Total derivatives		$ 160	$ 15

The Company did not have any derivatives not designated as hedging instruments for the thirteen and twenty-six weeks ended July 4, 2010 and June 28, 2009. The effect of derivative instruments on the Condensed Consolidated Statement of Operations for the thirteen and twenty-six weeks ended July 4, 2010 and June 28, 2009 was as follows:

Derivatives Designated as Cash Flow	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)			Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)		
	Thirteen Weeks Ended							
Hedging Instruments	July 4, 2010	June 28, 2009	Location	July 4, 2010	June 28, 2009	Location	July 4, 2010	June 28, 2009
Foreign currency contracts	$ (636)	$ 257	Cost of Services	$ 259	$ (398)	na	$	$

Derivatives Designated as Cash Flow Hedging Instruments	**Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)**		**Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)**			**Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)**		
	Twenty-Six Weeks Ended							
	July 4, 2010	**June 28, 2009**	**Location**	**July 4, 2010**	**June 28, 2009**	**Location**	**July 4, 2010**	**June 28, 2009**
Foreign currency contracts	$ (366)	$ 614	Cost of Services	$ 465	$ (942)	na	$	$

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13. Reclassifications

Certain immaterial amounts in the prior period financial statements have been reclassified to conform to the current period presentation.

14. Subsequent Events

The Company evaluated all events or transactions that occurred after the balance sheet date of July 4, 2010. The Company did not have any material recognizable subsequent events.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Our management s discussion and analysis of financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes thereto appearing elsewhere in this report and our audited consolidated financial statements which appear in Item 8 of Part II of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010. Our management s discussion and analysis contains forward-looking statements . All forward-looking statements are inherently uncertain as they are based on various expectations and assumptions about future events and are subject to known and unknown risks and uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from those expressed or implied by the forward-looking statements. See Forward Looking Statements and Factors That May Affect Future Results on page 3 and page 4 of this Quarterly Report on Form 10-Q and Item 1A in Part II of this Quarterly Report on Form 10-Q.

Overview

We are a leading provider of customer care services and solutions to market leaders in the communications, healthcare, business services, media & publishing, travel & entertainment, financial services, and technology industries. Our services are provided through customer care centers staffed with skilled customer service representatives in domestic, international, and client-owned locations. As of July 4, 2010, we operated 15 customer care centers; eight domestic, two domestic client-owned facilities, four off-shore centers located in the Philippines and one near-shore facility located in the Dominican Republic. As of July 4, 2010, our domestic operations consisted of approximately 6,300 workstations and our international operations consisted of approximately 4,200 workstations.

During 2008, we restructured our operations resulting in the reduction of overhead costs and headcount, refinanced our debt, and took steps to improve our operating efficiencies. Our focus on improving our financial performance resulted in increased gross profit margins, improved cash flow, lower levels of debt and profitability on a full year basis in fiscal year 2008. This transformation laid the foundation to return the Company to a sustainable, profitable operation.

During 2009, we continued to see a favorable impact from the initiatives launched in 2008. We expanded the sales organization and focused on expanding our service offerings and client base. We opened our fourth customer care center in the Philippines and a second customer care center in Tucson, Arizona, expanded our *at*HOME program, and began call center operations in the Dominican Republic. These actions resulted in an increase in revenue of 17.8% to $293.2 million for 2009 as compared to $248.8 million for 2008, and resulted in improvements in operating margins to 11.8% for 2009, as compared to 2.8% in 2008. Operating cash flow improved significantly allowing us to fully pay off all outstanding debt and establish a cash position of $20.6 million as of January 3, 2010. Because of the significant improvement in our forecasted financial performance, we reversed substantially all of the valuation allowance that had been provided against our deferred tax assets in the fourth quarter of fiscal year 2009.

During the first half of 2010, we saw continued improvement in our financial performance. Our revenue increased 16.8% to $162.6 million for the twenty-six weeks ended July 4, 2010, as compared to $139.3 million for the twenty-six weeks ended June 28, 2009. Our gross profit increased $2.8 million to $36.8 million for the twenty-six weeks ended July 4, 2010, as compared to $34.0 million for the twenty-six weeks ended June 28, 2009. Operating cash flow continued to be strong resulting in a cash position of $45.4 million as of July 4, 2010.

During the first half of 2010, we benefited from the addition of several new clients, the result of increasing our sales efforts. In addition, we have expanded our client services team to ensure we are continually focused on enhancing the quality, dependability and overall value of the services we provide for our clients.

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Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires us to make estimates and judgments that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Certain of our accounting policies are considered critical, due to the level of subjectivity and judgment necessary in applying these policies and because the impact of these estimates and assumptions on our financial condition and operating performance may be material. On an ongoing basis, we evaluate our estimates and judgments in these areas based on historic experience and other relevant factors. The estimates as of the date of the financial statements reflect our best judgment giving consideration to all currently available facts and circumstances. We believe our estimates and judgments are reasonable, however, actual results and the timing of the recognition of such amounts could differ from those estimates.

We have used methodologies that are consistent from year to year in all material respects. We have identified the following accounting policies and estimates that we believe are most critical in the preparation of our condensed consolidated financial statements: accounting for derivatives, allowance for doubtful accounts, accounting for employee benefits, revenue recognition, intangible assets, restructuring charges, accounting for stock-based compensation and income taxes. For details concerning these critical accounting policies and estimates see Item 7 of Part II of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010, under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates and Note 3 to our audited consolidated financial statements which appears in Item 8 of Part II of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010. Any deviation from these policies or estimates could have a material impact on our condensed consolidated financial statements.

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Results of Operations

The following table sets forth selected information about our results of operations for the thirteen and twenty-six weeks ended July 4, 2010 and June 28, 2009, respectively. Certain additional components of cost of services have been included as we believe they would enhance an understanding of our results of operations. All amounts in the table below are presented in thousands.

	Thirteen Weeks Ended			Twenty-Six Weeks Ended		
	July 4, 2010	June 28, 2009	Fav (Unfav) % Change	July 4, 2010	June 28, 2009	Fav (Unfav) % Change
Net Revenue	$ 77,386	$ 66,042	17.2%	$ 162,640	$ 139,288	16.8%
Cost of Services:						
Direct labor	41,170	34,212	(20.3)	86,372	72,520	(19.1)
Other facility expenses	19,839	16,426	(20.8)	39,445	32,814	(20.2)
Total cost of services	61,009	50,638	(20.5)	125,817	105,334	(19.4)
Percentage of revenue	78.8%	76.7%		77.4%	75.6%	
Gross profit	16,377	15,404	6.3	36,823	33,954	8.4
Gross profit margin	21.2%	23.3%		22.6%	24.4%	
Operating Expenses:						
Selling, general & administrative expenses	8,103	7,603	(6.6)	16,250	15,297	(6.2)
Legal settlement	7		*	2,407	4	*
Total operating expenses	8,110	7,603	(6.7)	18,657	15,301	(21.9)
Operating income	8,267	7,801	6.0	18,166	18,653	(2.6)
Other (income) expense	139	(23)	(704.3)	30	(30)	(200.0)
Interest (income) expense	(7)	(47)	(85.1)	(15)	42	135.7
Income before income taxes	8,135	7,871	3.4	18,151	18,641	(2.6)
Income tax expense	2,806	135	*	6,262	286	*
Net income	$ 5,329	$ 7,736	(31.1)%	$ 11,889	$ 18,355	(35.2)%

* Means that the percentage change is not meaningful

Non-GAAP Financial Measures

To supplement our Condensed Consolidated Financial Statements presented in accordance with GAAP, we present EBITDA, which is defined as a non-GAAP financial measure. The presentation of this non-GAAP financial measure is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. The items excluded from this non-GAAP financial measure are significant components of our financial statements and must be considered in performing a comprehensive analysis of our overall financial results.

We believe this non-GAAP financial measure provides meaningful supplemental information and is useful in understanding our results of operations and analyzing trends because it excludes certain charges such as interest, taxes, depreciation and amortization expenses that are not part of our ordinary business operations.

EBITDA is a measure used by our lenders, investors and analysts to evaluate our financial performance and our ability to pay interest and repay debt. This measure is also indicative of our ability to fund the capital investments necessary for our continued growth. We use this measure, together with our GAAP financial metrics, to assess our financial performance, allocate resources, measure our performance against debt covenants and evaluate our overall progress towards meeting our long-term financial objectives.

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We believe that this non-GAAP financial measure is useful to investors and analysts in allowing for greater transparency with respect to the supplemental information used by us in our financial and operational decision making. In addition, we believe investors, analysts and lenders benefit from referring to EBITDA when assessing our performance and expectations of our future performance. However, this information should not be used as a substitute for our GAAP financial information; rather it should be used in conjunction with financial statement information contained in our Condensed Consolidated Financial Statements presented in accordance with GAAP.
We use a consistent method for computation of EBITDA. Our calculation of EBITDA may not be consistent with calculations of similar measures used by other companies. The accompanying notes have more details on the GAAP financial measure that is most directly comparable to our non-GAAP financial measure and the related reconciliation between these financial measures.

	Thirteen Weeks Ended (1)			**Twenty-Six Weeks Ended**		
	July 4, 2010	**June 28, 2009**	**Fav (Unfav) % Change**	**July 4, 2010**	**June 28, 2009**	**Fav (Unfav) % Change**
	(Dollars in thousands except statistical data and notes)					
EBITDA (2)	$ 11,087	$ 10,777	2.9%	$ 24,207	$ 24,465	(1.1)%
Statistical information:						
Number of customer care centers:						
Domestic	10	9		10	9	
International	5	4		5	4	
Total	15	13		15	13	
Number of workstations, end of period:						
Domestic	6,267	5,396		6,267	5,396	
International	4,222	3,707		4,222	3,707	
Total	10,489	9,103		10,489	9,103	

Notes to Non-GAAP Financial Measures

(1) We operate on a thirteen-week fiscal quarter that ends on the Sunday closest to June 30.

(2) We define EBITDA as net income plus income tax expense (benefit),

depreciation and
amortization,
and interest
expense.

EBITDA is a measure used by our lenders, investors and analysts to evaluate our financial performance and our ability to pay interest and repay debt. This measure is also indicative of our ability to fund the capital investments necessary for our continued growth. We use this measure, together with our GAAP financial metrics, to assess our financial performance, allocate resources, measure our performance against debt covenants and evaluate our overall progress towards meeting our long-term financial objectives.

EBITDA is not intended to be considered in isolation or used as a substitute for net income or cash flow from operations data presented in accordance with GAAP or as a measure of liquidity. The items excluded from EBITDA are significant components of our statements of operations and must be considered in performing a comprehensive assessment of our overall financial results.

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EBITDA can be reconciled to net income, which we believe to be the most directly comparable financial measure calculated and presented in accordance with GAAP, as follows:

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
	(Dollars in thousands)			
Net income	$ 5,329	$ 7,736	$ 11,889	$ 18,355
Interest (income) expense	(7)	(47)	(15)	42
Income tax expense	2,806	135	6,262	286
Depreciation and amortization	2,959	2,953	6,071	5,782
EBITDA	$ 11,087	$ 10,777	$ 24,207	$ 24,465

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Comparison of Results of Operations for the Thirteen Weeks Ended July 4, 2010 and June 28, 2009

Net revenue increased 17.2% to $77.4 million for the thirteen weeks ended July 4, 2010, as compared to $66.0 million for the thirteen weeks ended June 28, 2009. The increase in revenue of $11.4 million is primarily driven by growth with existing and new clients of $3.4 million in the media & publishing vertical, $3.3 million in the communications vertical, $2.4 million in the business services vertical, $1.3 million in the healthcare vertical, $0.6 million in the financial services vertical, $0.5 million in the technology vertical and $0.4 of other services, partially offset by a decline in revenue of $0.5 million in the travel & entertainment vertical.

Cost of services increased $10.4 million, or 20.5%, to $61.0 million for the thirteen weeks ended July 4, 2010, from $50.6 million for the thirteen weeks ended June 28, 2009. Direct labor increased $7.0 million, or 20.3%, primarily driven by increased volume in the domestic communications, business services, media & publishing and healthcare verticals and by decreased domestic efficiencies. Facility and other costs increased $3.4 million, or 20.8%, due to $1.6 million of increased facility costs primarily related to the addition of our second customer care center in Tucson, Arizona, the opening of a customer care center in the Dominican Republic and increased growth at our customer care centers in Green Bay, Wisconsin and Davenport, Iowa, as well as at our fourth center in the Philippines. Other facility expenses increased $1.8 million due to $0.8 million of salaries and wages associated with increased operational support, $0.4 million of increased information technology costs, $0.3 million of increased telecommunication costs associated with increased volumes domestically and off-shore and $0.3 million of other facility expenses. Cost of services as a percentage of revenue increased to 78.8% for the thirteen weeks ended July 4, 2010, as compared to 76.7% for the thirteen weeks ended June 28, 2009, primarily due to increased facility and other costs and decreased domestic efficiencies.

Gross profit increased $1.0 million, or 6.3%, to $16.4 million for the thirteen weeks ended July 4, 2010, as compared to $15.4 million for the thirteen weeks ended June 28, 2009, primarily due to increased volume in the domestic communications, business services, media & publishing and healthcare verticals, partially offset by increased facility and other costs and decreased domestic efficiencies. Gross profit margin decreased from 23.3% for the thirteen weeks ended June 28, 2009 to 21.2% for the thirteen weeks ended July 4, 2010 driven by increased facility and other costs and decreased domestic efficiencies.

Selling, general and administrative expenses were $8.1 million for the thirteen weeks ended July 4, 2010, a $0.5 million increase from $7.6 million for the thirteen weeks ended June 28, 2009. The increase is primarily due to a $0.5 million increase in stock compensation expense resulting from the acceleration of expense related to the June 2010 retirement of two members of our Board of Directors, a $0.3 million increase in compensation and benefits primarily associated with an increase in our sales personnel and a $0.3 million increase in other expenses, partially offset by a $0.3 million decrease in costs associated with the final amortization of intangible assets, a $0.2 million decrease in professional fees and a $0.1 million decrease in bad debt expense.

Operating income was $8.3 million for the thirteen weeks ended July 4, 2010, as compared to $7.8 million for the thirteen weeks ended June 28, 2009. The $0.5 million increase is the result of an increase in gross profit, partially offset by an increase in selling, general and administrative expenses.

Net interest income of less than $0.1 million for the thirteen weeks ended July 4, 2010 was primarily related to $0.1 million from the amortization of points on forward contracts, offset by $0.1 million of fees associated with the Revolving Loan Facility with PNC. Net interest income of less than $0.1 million for the thirteen weeks ended June 28, 2009 was primarily related to $0.2 million from the amortization of points on forward contracts, partially offset by $0.2 million of fees and interest associated with borrowings under the Revolving Loan Facility with PNC.

EBITDA was $11.1 million for the thirteen weeks ended July 4, 2010, an increase of $0.3 million, as compared to $10.8 million for the thirteen weeks ended June 28, 2009. The increase was primarily due to an increase in gross profit, partially offset by an increase in selling, general and administrative expenses, as noted above. More information concerning this non-GAAP financial measure, including the definition of EBITDA and a reconciliation of this measure to the most directly comparable financial measure calculated and presented in accordance with GAAP, can be found under the heading Non-GAAP Financial Measures and the accompanying notes thereto appearing elsewhere in this Management s Discussion and Analysis of Financial Condition and Results of Operations.

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Income tax expense was $2.8 million for the thirteen weeks ended July 4, 2010 which represents an effective rate of 34.5%. This is lower than the statutory rate due to the generation of tax credits. Our estimated cash taxes for fiscal year 2010 will be approximately 5% of income before taxes due to the utilization of net operating loss carryforwards and tax credits. Income tax expense was $0.1 million for the thirteen weeks ended June 28, 2009. This was driven by a gross income earned tax of 5% on a portion of our Philippine financial results and domestic state income taxes. The Federal tax provision was fully offset by the utilization of net operating loss carryforwards and work opportunity tax credits. This resulted in a 1.7% effective income tax rate for the thirteen weeks ended June 28, 2009.

Net income for the thirteen weeks ended July 4, 2010 was $5.3 million, as compared to $7.7 million for the thirteen weeks ended June 28, 2009. The $2.4 million decrease was primarily due to the $2.7 million increase in income tax expense and the increase in selling, general and administrative expenses, partially offset by the improvement in gross profit, all as noted above.

Comparison of Results of Operations for the Twenty-six Weeks Ended July 4, 2010 and June 28, 2009

Net revenue increased 16.8% to $162.6 million for the twenty-six weeks ended July 4, 2010, as compared to $139.3 million for the twenty-six weeks ended June 28, 2009. The increase in revenue of $23.3 million is primarily drive by growth with existing and new clients of $9.8 million in the communications vertical, $5.9 million in the media & publishing vertical, $4.1 million in the business services vertical, $2.7 million in the healthcare vertical, $1.4 million in the financial services vertical, $0.5 million in the technology vertical and $0.4 million of other services, partially offset by a decline in revenue of $1.5 million in the travel & entertainment vertical.

Cost of services increased $20.5 million, or 19.4%, to $125.8 million for the twenty-six weeks ended July 4, 2010, from $105.3 million for the twenty-six weeks ended June 28, 2009. Direct labor increased $13.9 million, or 19.1%, primarily driven by increased volume in the domestic communications, business services and healthcare verticals, increased volume in the media & publishing vertical, both domestically and off-shore and by decreased domestic efficiencies, partially offset by lower healthcare volume off-shore and lower wage rates and employee benefits, both domestically and off-shore. Facility and other costs increased $6.6 million, or 20.2%, primarily due to $3.4 million of increased facility costs primarily related to the addition of our second customer care center in Tucson, Arizona, the opening of our fourth customer care center in the Philippines, the opening of a customer care center in the Dominican Republic and growth in our customer care centers in Green Bay, Wisconsin and Davenport, Iowa. Other facility expenses increased $3.2 million due to $1.6 million of salaries and wages associated with increased operational support, $0.6 million of telecommunication costs associated with increased volumes domestically and off-shore, $0.6 million of increased information technology costs and $0.4 million of other facility expenses. Cost of services as a percentage of revenue increased to 77.4% for the twenty-six weeks ended July 4, 2010, as compared to 75.6% for the twenty-six weeks ended June 28, 2009, as a result of increased facility and other costs and decreased domestic efficiencies.

Gross profit increased $2.8 million, or 8.4%, to $36.8 million for the twenty-six weeks ended July 4, 2010, as compared to $34.0 million for the twenty-six weeks ended June 28, 2009, primarily due to increased volume in the domestic communications, business services and healthcare verticals and increased volume in the media & publishing vertical, both domestically and off-shore, partially offset by lower healthcare volume off-shore, increased facility and other costs, and decreased domestic efficiencies. Gross profit margin decreased from 24.4% for the twenty-six weeks ended June 28, 2009 to 22.6% for the twenty-six weeks ended July 4, 2010 driven by increased facility and other costs and decreased domestic efficiencies.

Selling, general and administrative expenses were $16.3 million for the twenty-six weeks ended July 4, 2010, a 6.2% increase as compared to $15.3 million for the twenty-six weeks ended June 28, 2009. The $1.0 million increase is primarily due to a $1.0 million increase in stock compensation expense resulting from the acceleration of expense related to the June 2010 retirement of two members of our Board of Directors and the impact of an expense reversal during the first quarter of fiscal year 2009 related to options vesting at that time, but which were forfeited in earlier periods, a $0.6 million increase in compensation and benefits primarily associated with an increase in our sales and executive teams, a $0.3 million increase in travel and entertainment, and a $0.4 million net increase in other expenses, partially offset by a $0.6 million decrease in professional fees, a $0.4 million decrease in bad debt expense and a $0.3 million decrease in costs associated with the final amortization of intangible assets.

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Legal settlement expense was $2.4 million for the twenty-six weeks ended July 4, 2010 and related to the settlement of the Tiffany Sharpe, et al. v. APAC Customer Services, Inc. suit. Under the terms of the agreement, which was approved by the Court on June 16, 2010, we have agreed to pay a maximum amount of $4.0 million to resolve claims by eligible class members, including payments to class members and payments for plaintiff attorneys fees. The $2.4 million recorded for the twenty-six weeks ended July 4, 2010 represents our estimate of the costs to be incurred for attorneys fees and claims, based on expected opt-in rates for claimants in similar actions. The final amount which will ultimately be paid by us under the agreement will be determined based on the participation from eligible class members as well as the Court s final ruling with respect to plaintiff attorneys fees.

Operating income was $18.2 million for the twenty-six weeks ended July 4, 2010, as compared to $18.7 million for the twenty-six weeks ended June 28, 2009. The $0.5 million decrease was the result of the estimated legal settlement of $2.4 million and the $1.0 million increase in selling, general and administrative expenses, partially offset by $2.9 million increase in gross profit, as noted above.

Net interest income of less than $0.1 million for the twenty-six weeks ended July 4, 2010 was primarily related to $0.2 million from the amortization of points on forward contracts, partially offset by $0.2 million of fees associated with the Revolving Loan Facility with PNC. Net interest expense was less than $0.1 million for the twenty-six weeks ended June 28, 2009 and was primarily related to $0.4 million of fees and interest associated with borrowings under the Revolving Loan Facility, offset by $0.4 million related to the amortization of points on forward contracts.

EBITDA was $24.2 million for the twenty-six weeks ended July 4, 2010, a decrease of $0.3 million, as compared to $24.5 million for the twenty-six weeks ended June 28, 2009. The decrease was primarily due to the estimated legal settlement and the increase in selling, general and administrative expenses, partially offset by higher gross profit, as noted above. More information concerning this non-GAAP financial measure, including the definition of EBITDA and a reconciliation of this measure to the most directly comparable financial measure calculated and presented in accordance with GAAP, can be found under the heading Non-GAAP Financial Measures and the accompanying notes thereto appearing elsewhere in this Management s Discussion and Analysis of Financial Condition and Results of Operations.

Income tax expense was $6.3 million for the twenty-six weeks ended July 4, 2010 which represents an effective rate of 34.5%. This is lower than the statutory rate due to the generation of tax credits. Our estimated cash taxes for fiscal year 2010 will be approximately 5% of income before taxes due to the utilization of net operating loss carryforwards and tax credits. Income tax expense was $0.3 million for the twenty-six weeks ended June 28, 2009. This was driven by a gross income earned tax of 5% on a portion of our Philippine financial results and domestic state income taxes. The Federal tax provision was fully offset by the utilization of net operating loss carryforwards and work opportunity tax credits. This resulted in a 1.5% effective income tax rate for the twenty-six weeks ended June 28, 2009.

Net income for the twenty-six weeks ended July 4, 2010 was $11.9 million, as compared to $18.4 million for the twenty-six weeks ended June 28, 2009. The $6.5 million decrease was primarily due to a $6.0 million increase in income tax expense, the estimated legal settlement expense of $2.4 million and the increase in selling, general and administrative expenses of $1.0 million, partially offset by the $2.9 million increase in gross profit, all as noted above.

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Liquidity and Capital Resources

The following table sets forth our condensed consolidated statements of cash flow data for the twenty-six weeks ended July 4, 2010 and June 28, 2009, respectively.

	Twenty-Six Weeks Ended	
	July 4, 2010	June 28, 2009
	(Dollars in thousands)	
Net cash provided by operating activities	$ 28,961	$ 18,118
Net cash used in investing activities	(3,967)	(5,466)
Net cash provided by (used in) financing activities	201	(4,345)
Effect of exchange rate changes on cash	(336)	680
Net increase in cash and cash equivalents	$ 24,859	$ 8,987

Operating Activities

Net cash provided by operating activities increased approximately $10.8 million to $29.0 million for the twenty-six weeks ended July 4, 2010, as compared to $18.1 million for the twenty-six weeks ended June 28, 2009. The net increase was primarily due to a reduction in accounts receivable of $9.4 million, an increase of $2.4 million for estimated legal settlement expense and a decrease in deferred tax assets of $5.5 million, partially offset by a $6.5 million decrease in net income.

Investing Activities

Net cash used in investing activities decreased $1.5 million to $4.0 million for the twenty-six weeks ended July 4, 2010, as compared to $5.5 million for the twenty-six weeks ended June 28, 2009. Cash used in investing activities for the twenty-six weeks ended July 4, 2010 consisted primarily of $2.8 million in continued investment in operational and information technology equipment and $1.2 million in capital expenditures related to client implementations. Cash used in investing activities for the twenty-six weeks ended June 28, 2009 consisted primarily of $2.3 million in capital expenditures related to the build-out of our fourth customer care center in the Philippines, $2.2 million in capital expenditures related to client implementations and $1.0 million in continued investment in operational and information technology equipment.

Financing Activities

Net cash provided by financing activities of $0.2 million for the twenty-six weeks ended July 4, 2010 relates to $0.5 million in cash received from the exercise of stock options, partially offset by $0.3 million in payments on capital leases. Net cash used in financing activities of $4.3 million for the twenty-six weeks ended June 28, 2009 is the result of net payments of $6.1 million against the Revolving Loan Facility, offset by $1.8 million cash received from the exercise of stock options.

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Bank Financing

As of July 4, 2010, there were no outstanding borrowings under the Revolving Loan Agreement and we had cash and cash equivalents of $45.4 million.

During the twenty-six weeks ended July 4, 2010, we were party to a Revolving Credit and Security Agreement, as amended, (Revolving Loan Agreement) with PNC Bank National Association (PNC), as agent, and the financial institutions from time to time parties thereto as lenders. The Revolving Loan Agreement provides us with up to a $40.0 million revolving loan facility which expires in May 2011. The Revolving Loan Agreement contains certain financial covenants including limits on the amount of capital expenditures and maintenance of a minimum fixed charge coverage ratio. Other covenants in the Revolving Loan Agreement prohibit us (with limited exceptions) from incurring additional indebtedness, repurchasing outstanding common shares, permitting liens, acquiring, selling or disposing of certain assets, engaging in certain mergers and acquisitions, paying dividends or making certain restricted payments. Our ability to borrow under the Revolving Loan Agreement depends on the amount of eligible accounts receivable from our clients.

We had approximately $29.1 million of undrawn borrowing capacity under the Revolving Loan Agreement as of July 4, 2010, based upon borrowing base calculations. We were in compliance with our financial covenants as of July 4, 2010.

Future Liquidity

We expect that our cash balances of $45.4 million, cash flows from operations and available borrowings of $29.1 million under our Revolving Loan Agreement will be sufficient to meet projected operating needs, fund any planned capital expenditures and repay debt obligations for the next twelve months.

A significant change in operating cash flow or a failure to maintain profitability could have a material adverse effect on our liquidity and our ability to comply with the covenants in our Revolving Loan Agreement. In addition, our failure to adhere to the financial and other covenants could give rise to a default under the Revolving Loan Agreement which would have a material adverse effect on our liquidity and financial condition. There can be no assurances that we will be able to meet the financial and other covenants in our Revolving Loan Agreement.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Historically, we have been exposed to the impact of U.S. interest rate changes directly related to our normal operating and funding activities and foreign currency exchange risk related to our operating costs in the Philippines. Our Revolving Loan Agreement bears interest at floating rates, subjecting us to interest rate risk. To date, the impact from interest rate fluctuations has not been material. In 2008, we entered into a pay fixed / receive floating interest rate swap for a $5.0 million notional amount. The objective of the contract was to mitigate the variability in cash flows resulting from changes in the underlying interest rate index or changes in the LIBOR rate. The contract was terminated in June 2009 due to the elimination of outstanding borrowings.

The impact from foreign currency exchange rates has become significant due to the change in the U.S. dollar relative to the Philippine peso and the increase in cost of services due to our expanded operations in the Philippines. We manage this risk through a currency rate hedging program with the objective of mitigating the impact of significant fluctuations in the U.S. dollar / Philippine peso exchange rate. The objective of the hedge transaction is to mitigate the variability in cash flows and expenses over the period of the hedge contracts due to the foreign currency risk associated with the repayment of the intercompany accounts payable from the U.S. operations to the Philippines representing the Philippines share of revenue. Forward contracts to purchase approximately 1,017 million Philippine pesos at a U.S. dollar notional of $21.5 million were outstanding as of July 4, 2010.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As of July 4, 2010, under the direction of our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures. The term disclosure controls and procedures, as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as amended, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of July 4, 2010, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended July 4, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 1. Legal Proceedings

On May 27, 2009, a purported collective/class action complaint captioned Tiffany Sharpe, et al. v. APAC Customer Services, Inc. was filed in the United States District Court for the Western District of Wisconsin. On behalf of the named plaintiff, a non-exempt call center employee, and other similarly situated individuals, the complaint asserted violations under the Federal Fair Labor Standards Act (FLSA) related to overtime compensation and wage records. The complaint also asserted violations under Wisconsin Wage Payment and Overtime Compensation Laws based upon the same alleged facts. The complaint purported to allege claims as a nationwide collective action under federal law, as well as a class action under Wisconsin state law. The complaint sought various forms of relief, including injunctive relief, unpaid overtime wages, liquidated damages, interest, and attorneys fees and costs. On January 8, 2010, the court entered an order which conditionally certified the case as a collective action under the FLSA.

In March 2010, we entered into an agreement to resolve the collective action. On June 16, 2010, the Court entered an order approving the resolution of all claims under the FLSA collective action. Under the terms of the agreement, we agreed to pay a maximum amount of $4.0 million to resolve claims by eligible class members, including payments to class members and payments for plaintiff attorneys fees. As a result, we recorded a charge of $2.4 million for the thirteen weeks ended April 4, 2010 which represents our estimate of the costs to be incurred for attorneys fees and claims, based on expected opt-in rates for claimants in similar actions. The final amount which will ultimately be paid by us under the agreement will be determined based on the participation from eligible class members as well as the Court s final ruling with respect to plaintiff attorneys fees.

We denied and continue to deny the allegations in the complaint and contend that our policies and practices regarding compensation were proper and in compliance with the law at all times. We deny all liability and wrongdoing in this case, but have chosen to settle this lawsuit in order to avoid the distraction and additional legal expenses that would otherwise be incurred.

Item 1A. Risk Factors

For a detailed discussion of the risks and uncertainties associated with our business see Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010. There have been no material changes to these risk factors since that report.

Item 6. Exhibits

The exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index attached hereto.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	APAC Customer Services, Inc.
Date: August 11, 2010	By: /s/ Arthur D. DiBari
	Arthur D. DiBari Interim Chief Executive Officer (Principal Executive Officer)
Date: August 11, 2010	By: /s/ Andrew B. Szafran
	Andrew B. Szafran Senior Vice President and Chief Financial Officer (Principal Financial Officer)
Date: August 11, 2010	By: /s/ Joseph R. Doolan
	Joseph R. Doolan Vice President and Controller (Principal Accounting Officer)

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Exhibit Index

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation of APAC Customer Services, Inc., incorporated by reference to APAC Customer Services, Inc. s Annual Report on Form 10-K for the fiscal year ended January 1, 2006.
3.2	Second Amended and Restated Bylaws of APAC Customer Services, Inc., dated August 20, 2007, incorporated by reference to APAC Customer Services, Inc. s Current Report on Form 8-K, dated August 22, 2007.
4.1	Specimen Common Stock Certificate, incorporated by reference to APAC Customer Services, Inc. s Annual Report on Form 10-K for the fiscal year ended December 28, 2008.
10.1	Employment agreement with Eric Tinch, dated April 1, 2010, incorporated by reference to APAC Customer Services, Inc. s Current Report on Form 8-K, dated April 12, 2010.
31.1	Certification of Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.