SYKES ENTERPRISES INC
Form 10-Q
May 07, 2008

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

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2008

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________

Commission File No. 0-28274
Sykes Enterprises, Incorporated
(Exact name of Registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days.
Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o (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

As of April 18, 2008, there were 41,074,629 outstanding shares of common stock.

Sykes Enterprises, Incorporated and Subsidiaries

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PART I FINANCIAL INFORMATION
Item 1 Financial Statements

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

(in thousands, except per share data)	**March 31, 2008**	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	**$ 189,663**	$ 177,682
Receivables, net	**164,220**	145,490
Prepaid expenses	**14,779**	10,905
Other current assets	**15,773**	19,828
Short-term investments		17,827
Total current assets	**384,435**	371,732
Property and equipment, net	**78,543**	78,574
Goodwill, net	**22,286**	22,468
Intangibles, net	**6,216**	6,646
Deferred charges and other assets	**26,296**	26,055
	$ 517,776	$ 505,475
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	**$ 18,482**	$ 21,588
Accrued employee compensation and benefits	**44,943**	46,245
Income taxes payable	**4,736**	4,592
Deferred revenue	**30,684**	31,822
Other accrued expenses and current liabilities	**14,675**	14,132
Total current liabilities	**113,520**	118,379
Deferred grants	**10,097**	10,329
Long-term income tax liabilities	**4,961**	6,269
Other long-term liabilities	**6,422**	5,177
Total liabilities	**135,000**	140,154
Loss contingency (Note 15)		

Shareholders equity:		
Preferred stock, $0.01 par value, 10,000 shares authorized; no shares issued and outstanding		
Common stock, $0.01 par value, 200,000 shares authorized; 41,244 and 45,537 shares issued	**412**	455
Additional paid-in capital	**153,171**	184,184
Retained earnings	**192,337**	195,203
Accumulated other comprehensive income	**37,760**	37,457
Treasury stock at cost: 158 shares and 4,697 shares	**(904)**	(51,978)
Total shareholders equity	**382,776**	365,321
	$ 517,776	$ 505,475

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
(in thousands, except for per share data)	**2008**	**2007**
Revenues	**$ 203,721**	$ 168,001
Operating expenses:		
Direct salaries and related costs	**130,980**	105,871
General and administrative	**56,424**	48,555
Total operating expenses	**187,404**	154,426
Income from operations	**16,317**	13,575
Other income (expense):		
Interest income	**1,822**	1,349
Interest (expense)	**(102)**	(153)
Other income (expense)	**531**	(319)
Total other income (expense)	**2,251**	877
Income before provision for income taxes	**18,568**	14,452
Provision for income taxes	**2,858**	2,653
Net income	**$ 15,710**	$ 11,799
Net income per share:		
Basic	**$ 0.39**	$ 0.29
Diluted	**$ 0.38**	$ 0.29
Weighted average shares:		
Basic	**40,491**	40,299
Diluted	**40,813**	40,550

See accompanying notes to condensed consolidated financial statements.

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

(In thousands)	Common Stock Shares Issued	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at January 1, 2007	45,254	$453	$179,021	$158,058	$ 5,869	$(51,928)	$291,473
Adjustment upon adoption of FIN 48				(2,714)			(2,714)
Issuance of common stock	34		164				164
Stock-based compensation expense			979				979
Issuance of common stock and restricted stock under equity award plans	215	2	(2)				
Comprehensive income				11,799	2,203		14,002
Balance at March 31, 2007	45,503	455	180,162	167,143	8,072	(51,928)	303,904
Issuance of common stock	36		309				309
Stock-based compensation expense			3,192				3,192
Issuance of common stock and restricted stock under equity award plans	(27)		53				53
Issuance of common stock for business acquisition	25		468			(50)	418
Comprehensive income				28,060	29,385		57,445
Balance at December 31, 2007	45,537	455	184,184	195,203	37,457	(51,978)	365,321
Adjustment upon adoption of EITF 06-10				**(482)**			**(482)**
Issuance of common stock	**60**	**1**	**678**				**679**
Stock-based compensation expense			**1,246**				**1,246**
Issuance of common stock and restricted stock under equity award plans	**190**	**1**	**94**			**(96)**	**(1)**
Retirement of treasury stock	**(4,543)**	**(45)**	**(33,031)**	**(18,094)**		**51,170**	
Comprehensive income				**15,710**	**303**		**16,013**
Balance at March 31, 2008	**41,244**	**$412**	**$153,171**	**$192,337**	**$37,760**	**$ (904)**	**$382,776**

See accompanying notes to condensed consolidated financial statements.

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Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows
Three months ended March 31, 2008 and 2007
(Unaudited)

(in thousands)	**2008**	2007
Cash flows from operating activities:		
Net income	**$ 15,710**	$ 11,799
Depreciation and amortization	**7,019**	5,980
Stock compensation expense	**1,246**	979
Deferred income tax benefit	**(186)**	(272)
(Reversals of) termination costs associated with exit activities		(48)
Foreign exchange (gain) on liquidation of foreign entities	**(11)**	(2)
Bad debt expense	**393**	4
Unrealized loss on financial instruments, net	**691**	94
Amortization of discount on short-term investments	**(173)**	
Amortization of actuarial gains on pension	**(17)**	
Changes in assets and liabilities:		
Receivables	**(16,132)**	(4,761)
Prepaid expenses	**(3,941)**	(4,873)
Other current assets	**491**	83
Deferred charges and other assets	**804**	834
Accounts payable	**(2,133)**	(188)
Income taxes receivable/payable	**(1,197)**	697
Accrued employee compensation and benefits	**(2,247)**	(2,360)
Other accrued expenses and current liabilities	**753**	190
Deferred revenue	**(632)**	(3,552)
Other long-term liabilities	**598**	328
Net cash provided by operating activities	**1,036**	4,932
Cash flows from investing activities:		
Capital expenditures	**(8,063)**	(6,364)
Proceeds from sale of property and equipment	**51**	43
Proceeds from release of restricted cash	**373**	
Sale of short-term investments	**17,535**	
Purchase of short-term investments	**(175)**	
Investment in restricted cash	**(1,001)**	(893)
Other	**(128)**	3
Net cash provided by (used for) investing activities	**8,592**	(7,211)
Cash flows from financing activities:		
Proceeds from issuance of stock	**679**	164
Proceeds from short-term debt	**26**	
Payments on short-term debt	**(26)**	

Net cash provided by financing activities	**679**	164
Effects of exchange rates on cash	**1,674**	1,835
Net increase (decrease) in cash and cash equivalents	**11,981**	(280)
Cash and cash equivalents beginning	**177,682**	158,580
Cash and cash equivalents ending	**$ 189,663**	$ 158,300

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Sykes Enterprises, Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows
Three months ended March 31, 2008 and 2007
(Unaudited)

(Continued)

	2008	2007
Supplemental disclosures of cash flow information:		
Cash paid during period for interest	**$ 67**	$ 67
Cash paid during period for income taxes	**$ 4,061**	$ 2,272
Non-cash transactions:		
Property and equipment additions included in accounts payable	**$ 1,681**	**$** 2,405

See accompanying notes to condensed consolidated financial statements.

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Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Three months ended March 31, 2008 and 2007
(Unaudited)

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

Note 1 Basis of Presentation and Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for any future quarters or the year ending December 31, 2008. For further information, refer to the consolidated financial statements and notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007, as filed with the Securities and Exchange Commission (SEC).

Property and Equipment The carrying value of property and equipment to be held and used is evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* . An asset is considered to be impaired when the sum of the undiscounted future net cash flows expected to result from the use of the asset and its eventual disposition does not exceed its carrying amount. The amount of the impairment loss, if any, is measured as the amount by which the carrying value of the asset exceeds its estimated fair value, which is generally determined based on appraisals or sales prices of comparable assets. Occasionally, the Company redeploys property and equipment from under-utilized centers to other locations to improve capacity utilization if it is determined that the related undiscounted future cash flows in the under-utilized centers would not be sufficient to recover the carrying amount of these assets. The Company determined that its property and equipment was not impaired as of March 31, 2008.

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

Goodwill The Company accounts for goodwill and other intangible assets under SFAS No. 142 (SFAS 142), *Goodwill and Other Intangible Assets*. Goodwill and other intangible assets with indefinite lives are not subject to amortization, but instead must be reviewed at least annually, and more frequently in the presence of certain circumstances, for impairment by applying a fair value based test. Fair value for goodwill is based on discounted

Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Three months ended March 31, 2008 and 2007
(Unaudited)

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

Goodwill (continued)

cash flows, market multiples and/or appraised values as appropriate. Under SFAS 142, the carrying value of assets is calculated at the lowest levels for which there are identifiable cash flows (the reporting unit). If the fair value of the reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the fair value of the goodwill within the reporting unit is less than its carrying value. The Company completed its annual goodwill impairment test during the third quarter of 2007 and determined that the carrying amount of goodwill was not impaired. The Company expects to receive future benefits from previously acquired goodwill over an indefinite period of time.

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

Value Added Tax Receivables Our Philippine operations are subject to Value Added Tax, or VAT, which is usually applied to all goods and services purchased throughout the Philippines. Upon validation and certification of the VAT receivables by the Philippine government, the VAT receivables are held for sale through third-party brokers. This process through collection typically takes three to five years. The VAT receivable is approximately $8.7 million and $8.3 million as of March 31, 2008 and December 31, 2007, respectively, net of a valuation allowance of $2.3 million and $2.7 million, respectively. As of March 31, 2008 and December 31, 2007, the VAT receivables, net of the valuation allowance, of $5.1 million and $6.4 million, respectively, is included in Deferred Charges and Other Assets , $1.9 million and $0.0 million, respectively, is included in Prepaid Expenses and $1.7 million and $1.9 million, respectively, is included in Receivables in the accompanying Condensed Consolidated Financial Statements. We review our VAT receivable balance for impairment whenever events or changes in circumstances indicate the carrying amount might not be recoverable. During the three months ended March 31, 2008, the Company determined that a portion of the VAT receivable balance was not recoverable and wrote down the balance by $0.3 million.

Stock-Based Compensation The Company has three stock-based compensation plans: the 2001 Equity Incentive Plan (for employees and certain non-employees), the 2004 Non-Employee Director Fee Plan (for non-employee directors), both approved by the shareholders, and the Deferred Compensation Plan (for certain eligible employees), which are discussed more fully in Note 13. Stock-based awards under these plans may consist of common stock, common stock units, stock options, cash-settled or stock-settled stock appreciation rights, restricted stock and other stock-based awards. The Company issues common stock to satisfy stock option exercises or vesting of stock awards. The Company recognizes in its income statement the grant-date fair value of stock options and other equity-based compensation issued to employees and directors. Compensation expense for equity-based awards is recognized over the requisite service period, usually the vesting period, while compensation expense for liability-based awards (those usually settled in cash rather than stock) is measured to fair-value at each balance sheet date until the award is settled.

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

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Sykes Enterprises, Incorporated and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Three months ended March 31, 2008 and 2007
(Unaudited)

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

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

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

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedging activities. This process includes linking all derivatives that are designated as cash flow hedges to forecasted transactions. The Company also formally assesses, both at the hedge s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items on a prospective and retrospective basis. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge or if a forecasted hedge is no longer probable of occurring, the Company discontinues hedge accounting prospectively. At March 31, 2008, all hedges were determined to be highly effective.

The Company also periodically enters into forward contracts that are not designated as hedges. The purpose of these derivative instruments is to reduce the effects on its operating results and cash flows from fluctuations caused by volatility in currency exchange rates. The Company records changes in the fair value of these derivative instruments within Revenues . See Note 4 for further information on financial derivative instruments.

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

SFAS 159 permits an entity to measure certain financial assets and financial liabilities at fair value with changes in fair value recognized in earnings each period. During the three months ended March 31, 2008, the Company has not elected to use the fair value option permitted under SFAS 159 for any of its financial assets and financial liabilities that are not already recorded at fair value.

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

Fair Value Hierarchy SFAS 157 requires disclosure about how fair value is determined for assets and liabilities and establishes a hierarchy for which these assets and liabilities must be grouped, based on significant levels of observable or unobservable inputs. Observable inputs reflect market data obtained from independent sources, while

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Sykes Enterprises, Incorporated and Subsidiaries
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Three months ended March 31, 2008 and 2007
(Unaudited)

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

Fair Value Measurements (continued)

unobservable inputs reflect the Company s market assumptions. This hierarchy requires the use of observable market data when available. These two types of inputs have created the following fair-value hierarchy:

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

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

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

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

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

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

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

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

Investments Held in Rabbi Trust and related Deferred Compensation Plan Liability The Company maintains a non-qualified deferred compensation plan structured as a rabbi trust for certain eligible employees. The investment assets of the rabbi trust are valued using quoted market prices multiplied by the number of shares held in the trust, which are classified in Level 1 of the fair value hierarchy. The related deferred compensation liability represents the fair value of the investment assets discounted for the Company s credit risk taking into consideration the legal rights of participants to receive deferred amounts, which is classified in Level 2 of the fair value hierarchy. For additional information about our deferred compensation plan, refer to Note 13 of the accompanying Condensed Consolidated Financial Statements.

Guaranteed Investment Certificates The Company s guaranteed investment certificates has a variable interest rate linked to the prime rate and approximates fair value due to the automatic ability to reprice with changes in the market; such items are classified in Level 2 of the fair value hierarchy.

Value Added Tax Receivable The value added tax VAT receivable is recorded at carrying value (net of valuation allowances), which approximates fair value. The Company recognizes a valuation allowance based on such factors

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

Fair Value Measurements (continued)