

APAC CUSTOMER SERVICE INC  
Form 10-K  
March 16, 2005

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended January 2, 2005  
OR

- 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**

(State or other jurisdiction  
of incorporation or organization)

**36-2777140**

(I.R.S. employer  
identification no.)

**Six Parkway North, Suite 400, Deerfield, Illinois 60015**

(Address of principal executive offices)

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

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

Securities registered pursuant to Section 12(g) of the Act: **Common Shares, \$0.01 Par Value**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

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Yes  No

The aggregate market value of the Registrant's Common Shares held by non-affiliates was approximately \$43,366,000 based on the last sale price as of June 27, 2004.

As of March 14, 2005, 49,454,654 Common Shares were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Certain portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on June 3, 2005, are incorporated by reference into Part III of this Form 10-K.

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**PART I**

**Item 1. Business**

**General**

APAC Customer Services, Inc. and its subsidiaries (collectively "APAC Customer Services", "APAC" or the "Company") was founded in 1973 and is a leading provider of customer interaction solutions for market leaders in communications, financial services, health care, logistics, publishing, insurance and travel and hospitality. To help its clients serve their customers better, APAC Customer Services provides customer care and customer acquisition programs. The Company is presently engaged in a major transformational effort intended to result in a high performing workforce providing quality service to its clients, which in turn is expected to increase client retention and sales growth. Included in this effort are investments in people, process and technology. The Company currently operates and manages approximately 6,900 workstations in 24 Customer Interaction Centers. (See Item 2. "Properties").

**Services**

*Customer care.* Customer care services include customer relationship management solutions, including inbound customer services, customer retention, direct mail response, "help" line support, and customer order processing. Certain customer care services utilize specialized customer service representatives, such as licensed insurance agents and licensed pharmacists, capable of responding to inquiries requiring subject matter expertise.

Customer care services involve the receipt, identification and routing of calls from a client's customers or prospects to the appropriate APAC customer service representative. The caller typically uses a toll-free number to request product or service information, place an order for a product or service or obtain assistance regarding a client's products or services. APAC utilizes automated call distributors and digital switches to identify each inbound call by number and route the call to an APAC customer service representative trained for the client's specific program. Simultaneously with receipt of the call, the customer service representative's computer screen displays customer, product and service information relevant to the call. The Company reports information and results captured during the call to its client for order processing, customer service and database management.

*Customer acquisition.* Customer acquisition services involve an APAC sales representative's calling a consumer or business prospect to offer the client's products or services. APAC receives prospect information electronically from its clients. APAC's leads management system sorts the prospect information and delivers it to one or more of its Customer Interaction Centers. Computerized call-management systems generally utilizing predictive dialers automatically dial the telephone numbers, determine if a live connection is made, and present connected calls to sales representatives who have been specifically trained for the client's program. When a call is presented, the prospect's name, other information about the prospect and the program script simultaneously appear on the sales representative's computer screen. The sales representative then uses the script to solicit an order for the client's product or service or to request information, which will be added to the client's customer database.

*New Services.* The Company has various new service offerings in development or in pilot production mode. These include consulting services to increase the quality and efficiency of call center services provided by others; at-home agents who would provide services to certain of the Company's clients by working at home on computer equipment linked to the Company's systems; technical help desk services, and independent quality monitoring services that the Company would provide to call centers operated by others.

## Clients

APAC directs its business development efforts primarily towards large companies with substantial customer care and/or customer acquisition needs. APAC develops and delivers customer care and acquisition solutions primarily in the following industries:

Communications	Logistics
Financial Services	Publishing
Health Care	Insurance
	Travel and Hospitality

The Company's ten largest clients collectively accounted for 69.5% of the Company's net revenue in fiscal 2004. Three of the Company's clients were each responsible for 10.0% or more of the Company's net revenues: T-Mobile USA provided 12.3% of the Company's net revenues in fiscal 2004, Citigroup Inc. accounted for 10.6% of the Company's net revenues and United Parcel Services, Inc. ("UPS") accounted for 10.0% of the Company's net revenues. See "Client Concentration; Contract Terms; Client Industries" in "Information Regarding Forward-Looking Statements" in Part II.

## Client Relationships

APAC provides services to its clients pursuant to written contracts, which generally provide for engagements of one to five years. Most contracts permit clients to terminate for convenience. Many contracts for customer care services require adherence to a termination schedule allowing for the gradual reduction of services over a three to six month period in the event of termination. Contracts for customer acquisition services may generally be terminated or modified on short notice. The Company has, however, historically established long-term relationships with many of the clients for which it provides such services.

Client contracts require that the Company bill for its services on the basis of time spent by the Company representatives providing services. Time can be billed on an hours or minutes basis. Billing for minutes of services, which is increasingly common in the industry, requires greater Company representative productivity to achieve an equivalent hourly rate. The Company is also receiving requests to price services on a per call or per transaction basis, thereby shifting additional operational risk to the Company, since managing the duration of each call is critical to achieving efficiency under this pricing method. The Company is generally subject to varying client performance standards, such as average handle time, occupancy rate, abandonment rate and sales per hour. The Company's performance against such standards may provide bonus opportunities or, conversely, may subject the Company to penalties. The Company's customer acquisition services are increasingly priced on a pay-for-performance basis, where the Company typically receives fees that are a combination of base-rate plus fee per sale. See "Client Concentration; Contract Terms; Client Industries" in "Information Regarding Forward-Looking Statements" in Part II.

## Capacity and Capacity Utilization

The Company provides customer interaction solutions through the operation of 24 Customer Interaction Centers. The Company's Customer Interaction Centers can be configured to specific customer needs. In addition to its 23 domestic centers, the Company operates an approximately 73,000 square foot Customer Interaction Center in Muntinlupa City, Philippines. The Company's Philippine center receives or initiates calls only from or to customers in the United States in accordance with the Company's contracts with domestic companies. These contracts are denominated in U.S. dollars.

The Company's profitability is influenced significantly by its Customer Interaction Center capacity utilization. The Company closely monitors the capacity utilization of its Customer Interaction Centers and balances the costs associated with maintaining excess capacity with the flexibility needed to quickly respond to

incremental client demands when determining whether to maintain presently unutilized capacity. The Company is implementing Aspect/eWorkforce Management ("eWFM"), a leading workforce administration platform, with the expectation of increased efficiencies. See "Technology and Telecommunications."

### **Technology and Telecommunications**

APAC integrates call interaction management, database marketing and management information systems within its network of Customer Interaction Centers.

The Company has developed a UNIX-based computer system, which utilizes a "hub and spoke" configuration to electronically link each Customer Interaction Center's systems to the Company's data center. This system architecture provides the Company with the flexibility to integrate its client server and mid-range systems with the variety of systems maintained by its clients. By integrating with its clients' systems, APAC is able to send and receive voice and data directly from its clients' in-house systems, transfer calls to its clients' in-house telephone representatives when appropriate, and report the status and results of the Company's services. APAC also utilizes VOIP technology, which enables calls to be routed throughout the enterprise using internet protocol. APAC's custom software solutions are built on Oracle's relational database technology, which enables the Company to design tailored software applications for its clients.

The Company is implementing eWFM, a leading workforce administration platform, across all of its operations. The rollout of eWFM is expected to result in increased operational efficiencies and greater centralized Customer Interaction Center management, enabling the Company to better forecast client call volumes and schedule labor in order to meet fluctuating client demands. The Company is also implementing an Advanced Call routing system in order to provide maximum call distribution flexibility among the Company's Customer Interaction Centers.

The Company is also implementing eWitness, a leading quality monitoring and management platform, across all of its operations. eWitness, in concert with revised methods in which representatives are trained, monitored and coached throughout the Company, is expected to improve the Company's ability to provide high quality services to its clients.

APAC's multichannel customer relationship management platform, known as e.PAC®, leverages off-the-shelf applications, in-house developed software, and integrated reporting to provide a 360-degree view of the customer through the use of an integrated routing layer and a contact management application layer. Multiple communications channels are linked into the contact management layer to allow clients' customers to contact APAC using any communication medium they choose, including voice, e-mail, internet chat and web collaboration.

The Company contracts with multiple providers of nationwide long distance networks and services and has the ability to allocate call volumes among these providers to ensure optimal utilization of long distance services. The Company obtains pricing based on its volume commitments, which include "take or pay" features obligating the Company to pay for a minimum usage regardless of whether such minimum services are utilized. The Company's management believes that it structures the volume guarantees and timing of its contracts so as to minimize any potential payment resulting from the take-or-pay aspect of its commitments.

### **Sales and Marketing**

The Company utilizes a targeted approach to identify new clients and additional needs of existing clients. The Company markets its services by targeting companies for proactive development of industry specific solutions, expanding relationships with existing clients, responding to requests for proposals, pursuing client referrals, participating in trade shows and advertising in business publications.

## Human Resources

The Company's representatives are key to its success in providing quality services to its clients. The Company is implementing various hiring, training, compensation and other systems across its Customer Interaction Centers with a view towards enhancing the quality of services provided. Company's management also believes that the implementation of such programs will have a significant and positive effect on the Company's ability to retain its representatives.

The Company hires its representatives according to a hiring model designed to select employees motivated to provide services of first rate quality. The Company has instituted a performance management review process and a pay for performance compensation program. In addition, the Company, working with an outside consultant, has designed and is implementing a Company wide training program called "The APAC Way" which includes 1.5 days of service and sales training for all representatives, direct supervisory staff, line management and operations support employees. In addition, the Company provides client specific training to all representatives, ranging in complexity and duration with client program requirements. Many client programs also require additional ongoing training as client product and service requirements change. While contract terms vary, most clients either pay for some training, at a reduced billing rate, or do not pay for training.

The Company also provides coaching, management and leadership training to front line supervisors and all management employees. Deployment of eWitness throughout the Company will also provide a means for front line supervisors to provide coaching opportunities to representatives by direct observation, as does the centralized quality function described below. "See "Technology and Telecommunications" and "Quality".

The Company had approximately 8,300 full-time and 1,900 part-time employees for a total of approximately 10,200 employees on March 14, 2005. None of APAC's employees is subject to a collective bargaining agreement. The Company considers its relations with its employees to be satisfactory.

## Quality

Management believes the Company's ability to retain existing clients and to acquire new clients is directly related to the quality of the services provided by APAC.

The Company is in the process of implementing eWitness, a quality monitoring system, across the Company's Customer Interaction Centers. The implementation includes the creation of a centralized quality monitoring group that will provide an independent and ongoing assessment of program quality through calibration with clients and direct monitoring of individual representatives. In addition, front line management at each Customer Interaction Center is receiving training designed to provide multiple coaching sessions per week for each representative utilizing the eWitness tool.

The Company also regularly measures the quality of its services by benchmarking such factors as client satisfaction, customer service levels, average handle times, first call resolutions, sales per hour and average speed of answer. The Company is able to provide clients with status reports on a real-time basis and can transmit summary data and captured information electronically to clients. This data enables APAC and its clients to modify or enhance ongoing services to improve quality and effectiveness.

## Competition

The industry in which the Company operates is competitive and highly fragmented. APAC's competitors range in size from very small firms offering specialized applications or short-term projects to large independent public firms and the in-house operations of many clients and potential clients. A number of competitors have capabilities and resources equal to, or greater than, the Company's, including large multinational business outsourcing providers. In-house telemarketing, customer relationship management and customer service organizations comprise by far the largest segment of the industry. Customer care and

acquisition services are also being provided offshore, in India, the Philippines, the Caribbean and other locations. Such services are being offered by certain of the competitors described earlier and by locally owned operators providing services directly into the U.S. market as well.

In addition, some of the Company's services also compete with other forms of direct marketing such as mail, e-mail, television and radio. The Company believes that the principal competitive distinctions in the industry are reputation for quality, performance against client metrics, price, technological expertise, scalability and the ability to provide clients with customized solutions quickly.

### **Financial Information About Industry Segments**

The Company operates its business in a single operating segment as defined in Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information."

### **Government Regulation**

Telephone sales practices are regulated at both the Federal and state levels. On the Federal level, both the Federal Trade Commission ("FTC") and the Federal Communications Commission ("FCC") regulate the initiation of telephone solicitations to residential telephone subscribers. The FTC maintains a "Do Not Call Registry" (the "Registry"). Consumers may sign on to the Registry by telephone or through the Registry's website. Telephone solicitations may not be initiated with respect to those numbers entered on the Registry. There are some exceptions to this, including the "existing business relationship" exemption, which permits calls to be made to consumers on the Registry if such consumers were existing customers or made inquiry of the company whose products or services are offered within eighteen or three months, respectively. In addition, the FCC requires companies to maintain "company specific" do not call lists for consumers who have requested that such particular company not call them.

The FTC and FCC regulate the use of predictive dialers by requiring that companies limit the percentage of calls abandoned to 3% in the event that no customer service representative is available to take the call at the time the consumer becomes available. This regulation also requires that receiving telephones be permitted to ring for a specified duration and that callers leave a recorded message identifying the caller and the purpose of the call, among other things.

The FTC and FCC also require that a company initiating telephone solicitations transmit company identifying and number information for recognition by consumers' caller identification systems. The FCC precludes the initiation of telephone solicitations to residential telephone subscribers before 8:00 am or after 9:00 pm. The FTC imposes restrictions on the use of pre-acquired account information when such information is to be used for billing purposes and requires that various disclosures be made in the context of certain sales.

States have also continued to enact legislation governing telephone solicitations, including state do not call registries, restrictions on methods and timing of calls, restrictions on the percentage of abandoned calls, mandated disclosures, caller identification requirements, registration requirements and other regulation of sales by telephone. In addition, state and the Federal governments are considering legislation mandating disclosure regarding the location of the service representative placing or answering the calls.

Companies that violate Federal or state regulations may be subject to enforcement actions, civil actions or private causes of action initiated by the consumer.

The Company has policies, procedures and technology in place intended to meet the requirements of the applicable regulations pertaining to telephone solicitations.

In addition to the laws regulating telephone sales activity, federal and state laws and regulations govern consumer privacy and the collection and use of consumer data. Key federal laws include the



Gramm-Leach-Bliley Act and the Health Insurance Portability and Accountability Act. There is increasing federal and state interest in privacy protections, some aspects of which could impose additional regulatory pressure on the business of the Company's clients and, less directly, on the Company's business.

The industries served by the Company are also subject to varying degrees of government regulation. The Company and its employees who are involved in certain types of sales activities, such as the sale of insurance products, are required to be licensed by various state commissions or regulatory bodies and to comply with regulations enacted by those entities. Other examples of activities requiring licensing include gaming, pharmaceutical and mortgage banking activities.

#### **Available Information**

The Company files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). These filings are available to the public over the Internet at the SEC's website at *www.sec.gov*. The documents APAC files with the SEC may also be read and copied at the SEC's public reference room located at 450 Fifth Street, NW, Washington, DC 20549. Information regarding the SEC's public reference room may be obtained by calling the SEC at 1-800-SEC-0330.

The Company maintains a website with the address *www.apaccustomerservices.com*. The Company is not including the information contained on its website as a part of, or incorporating it by reference into, this Annual Report on Form 10-K. The Company makes available free of charge (other than an investor's own Internet access charges) through its website the Company's Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after the Company electronically files such material with, or furnishes such material to, the SEC.

#### **Item 2. Properties**

The Company leases approximately 91,000 square feet of office space in Deerfield, Illinois. The term of this lease expires in August 2008. The Deerfield space houses corporate headquarters, a data center, a call center and a technology demonstration center. The Company leases 73,000 square feet of space for its Philippines Customer Interaction Center, which provides 600 seats. The Company has approximately 79,000 square feet of office space in Cedar Rapids, Iowa. This office space is located on all or part of six floors, which are owned by the Company, and is part of an office condominium. The Company also leases approximately 87,000 square feet of office space in Omaha, Nebraska. The lease for the Omaha office space expires in August 2007. Approximately 49,000 square feet of this space is sublet.

As of January 2, 2005, the Company operated Customer Interaction Centers and workstations in the following states and foreign country:

#### Customer Interaction Centers

States	Number of Centers	Number of Workstations
Arizona	1	629
Iowa	7	1,448
Illinois	5	556
Kansas	1	120
Missouri	1	96
Nebraska	1	323
New York	1	405
Oklahoma	2	304
Texas	1	873
Virginia	1	717
Wisconsin	2	815
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Total US Based	23	6,286
Philippines	1	600
	<hr/>	<hr/>
Total	24	6,886
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The Company closed three Customer Interaction Centers in fiscal 2004 and transitioned one call center to a client resulting in the elimination of 554 workstations. The leases of the remaining Customer Interaction Centers have terms ranging from one to six years and typically contain renewal options and early termination buyouts.

Management believes that while APAC's facilities are maintained in good condition and are generally suitable and of sufficient capacity for the Company's current operations, the transformation of the Company to a higher quality service model may require investment in updating or relocating some of the existing Customer Interaction Centers. APAC's management believes that capacity can be expanded or contracted relatively quickly to accommodate changes in the Company's operations.

### Item 3. Legal Proceedings

In December of 2000, the Company entered into a contract with Apogee Enterprises, Inc. to provide call center services and to develop software applications supporting those services for its Harmon Glass Solutions division ("Harmon"). Apogee sold Harmon to the Dwyer Group in 2004. The Company's revenues under this contract in fiscal 2003 and 2004 were \$5.1 million and \$1.9 million, respectively. Disputes and claims under this contract are the subject of an arbitration proceeding filed on April 8, 2004 with the American Arbitration Association. Harmon has alleged that the Company breached its obligations under the contract thereby damaging Harmon's business. The Company contends that it has performed its obligations under the contract, and claims that Harmon has breached the contract and owes the Company damages and a termination fee as provided for in the contract. The Company intends to vigorously assert its claims and defenses. However, given the preliminary nature of this matter and the uncertainties inherent in any litigation, it is not possible to predict the outcome of this proceeding and there can be no assurance that the Company will be successful or that an adverse outcome would not be material.

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

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Executive Officers of the Registrant**

The executive officers of the Company are as follows:

<b>Name</b>	<b>Age</b>	<b>Position</b>
Robert J. Keller	51	Director, President and Chief Executive Officer
Kenneth R. Batko	54	Vice President and Controller
James M. McClenahan	46	Senior Vice President, Sales & Marketing
Mark E. McDermott	44	Senior Vice President and Chief Information Officer
Susan L. Menzel	39	Senior Vice President, Human Resources
Marc T. Tanenberg	53	Senior Vice President, Chief Financial Officer and Treasurer
Linda R. Witte	52	Senior Vice President, General Counsel and Secretary

Robert J. Keller joined the Company as President and Chief Executive Officer as of March 2004. Mr. Keller is also a Director of the Company. From February of 1998, Mr. Keller served in various capacities at Office Depot, Inc., most recently as President, Business Services Group. Prior to joining Office Depot, Inc. Mr. Keller was Executive Vice President (1993-1998) and Senior Vice President (1988-1993) of Dun & Bradstreet Corporation. Previously Mr. Keller was employed by IBM Corporation.

Kenneth R. Batko joined the Company in March 2000 as Vice President and Controller. From November 1997 to February 2000, Mr. Batko was Vice President, Corporate Controller of GeoLogistics Corporation. Mr. Batko was employed by Anixter International Inc. from June 1982 through October 1997, where he held various positions, most recently Assistant Controller. Prior to June 1982, Mr. Batko was employed as a manager by Ernst & Young LLP. Mr. Batko is a Certified Public Accountant.

James McClenahan joined the Company in May 2004 as the Senior Vice President, Sales and Marketing. From September 2002 to May 2004, Mr. McClenahan was employed by Danka Office Imaging as President, Latin America Division. From July 1996 to May 2002, Mr. McClenahan was employed by Office Depot, Inc. where he held various positions, most recently Senior Vice President of Central Region Sales, Business Services Division.

Mark E. McDermott joined the company in March of 1996 and was promoted to Senior Vice President and Chief Information Officer in April of 2004. From October of 1993 through March 1996 Mr. McDermott was employed at Discovery Zone, Inc. as Senior Vice President, Information Technology. From June 1982 through September 1993, Mr. McDermott was employed by Waste Management, Inc. where he held various positions within the technology and strategic services organizations.

Susan L. Menzel joined the Company as the Senior Vice President, Human Resources in July 2004. From 1997 to 2004, Ms. Menzel was employed by Sears Roebuck & Company in a variety of positions, most recently as Vice President Human Resources.

Marc T. Tanenberg joined the Company in August 2001 as Senior Vice President, Chief Financial Officer and Treasurer. From November 1993 to August 2001, Mr. Tanenberg was employed by International Jensen Incorporated where he held a variety of positions, most recently Executive Vice President, Operations and Chief Financial Officer. Mr. Tanenberg is a Certified Public Accountant.

Linda R. Witte, Senior Vice President, General Counsel and Secretary, joined the Company in June 1999. Previously, Ms. Witte was Senior Vice President, General Counsel and Secretary of Beloit Corporation, an 80% owned subsidiary of Joy Global, Inc., and Vice President and General Counsel of Wheelabrator Water Technologies, Inc., a division of Waste Management, Inc. Before joining Waste Management, Ms. Witte was a partner in Jenner & Block, a national law firm headquartered in Chicago, IL.

## PART II

**Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities**

The Company's Common Stock is quoted on the NASDAQ National Market under the symbol "APAC." The following table sets forth, for the periods indicated, the high and low sale prices of the Common Shares as reported on the NASDAQ National Market during such period.

	<u>High</u>	<u>Low</u>
Fiscal 2004:		
First Quarter	\$ 3.39	\$ 2.34
Second Quarter	\$ 3.15	\$ 1.65
Third Quarter	\$ 1.90	\$ 1.50
Fourth Quarter	\$ 1.79	\$ 1.45
	<u>High</u>	<u>Low</u>
Fiscal 2003:		
First Quarter	\$ 3.02	\$ 2.30
Second Quarter	\$ 3.20	\$ 2.41
Third Quarter	\$ 3.06	\$ 2.52
Fourth Quarter	\$ 2.90	\$ 2.51

As of March 14, 2005, there were 1,012 holders of record of the Common Shares. The Company did not pay any dividends on its Common Shares in fiscal years 2004 or 2003 nor did it repurchase any Common Shares. The Company currently intends to retain future earnings to finance its growth and development and, therefore, does not anticipate paying any cash dividends or purchases of any Common Shares in the foreseeable future. In addition, the Company's Credit Agreement (defined in the Liquidity Section of Management's Discussion and Analysis of Financial Condition and Results of Operations) restricts the payment of cash dividends and the repurchase of Common Shares by the Company. Payment of any future dividends or purchases of any Common Shares will depend upon the future earnings and capital requirements of the Company and other factors the Board of Directors considers appropriate. See "Equity Compensation Plan Information" in Item 12. and "Security Ownership of Certain Beneficial Owners and Management" in Part III.

## Item 6. Selected Financial Data

## APAC CUSTOMER SERVICES, INC.

## SELECTED FINANCIAL DATA

For the Fiscal Years Ended(1)

	January 2, 2005	December 28, 2003	December 29, 2002	December 30, 2001	December 31, 2000
(In thousands, except per share, statistical data and notes)					
<b>OPERATING DATA:</b>					
Net revenue	\$ 273,239	\$ 322,852	\$ 371,198	\$ 428,844	\$ 464,355
Cost of services(2)	239,783	263,153	295,874	356,221	359,669
Selling, general and administrative expenses	39,712	48,633	50,283	56,967	59,921
Restructuring and other charges(3)	1,873	3,238	8,139	9,004	8,689
Asset impairment charges(4)	2,234	420	1,005	8,608	
Operating income (loss)	(10,363)	7,408	15,897	(1,956)	36,076
Interest expense, net	259	1,031	6,485	7,778	9,350
Income taxes (benefit)	(4,123)	2,038	3,218	(4,770)	10,056
Income (loss) from continuing operations	(6,499)	4,339	6,194	(4,964)	16,670
Gain from discontinued operations(5)					511
Net income (loss)	\$ (6,499)	\$ 4,339	\$ 6,194	\$ (4,964)	\$ 17,181
<b>Net income (loss) per share:</b>					
Basic:					
Continuing operations	\$ (0.13)	\$ 0.09	\$ 0.13	\$ (0.10)	\$ 0.35
Discontinued operations					0.01
Net income (loss)	\$ (0.13)	\$ 0.09	\$ 0.13	\$ (0.10)	\$ 0.36
Diluted:					
Continuing operations	\$ (0.13)	\$ 0.09	\$ 0.13	\$ (0.10)	\$ 0.33
Discontinued operations					0.01
Net income (loss)	\$ (0.13)	\$ 0.09	\$ 0.13	\$ (0.10)	\$ 0.34
Weighted average shares outstanding:					
Basic:	49,453	49,436	49,244	48,780	48,286
Diluted:	49,453	49,461	49,415	48,780	50,952
<b>BALANCE SHEET DATA:</b>					
Cash and cash equivalents	\$ 271	\$ 11,428	\$ 14,530	\$ 21,213	\$ 41,192
Working capital	8,511	15,681	37,367	27,793	51,060
Capital expenditures	11,206	8,348	6,494	8,971	15,236
Total assets	119,533	134,593	149,394	183,710	231,795
Long-term debt, less current maturities		313	28,872	42,968	84,483
Shareholders' equity	74,163	80,730	76,427	67,997	73,811
<b>STATISTICAL DATA: (UNAUDITED)</b>					
Number of Customer Interaction Centers(6)	24	28	32	48	57
Number of workstations(6)	6,886	6,982	7,523	10,208	10,522

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For the Fiscal Years Ended(1)

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Net Revenue per workstations(7)	\$	40,144	\$	42,870	\$	39,479	\$	41,563	\$	43,848
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**NOTES:**

- (1) The Company operates on a 52/53-week fiscal year that ends on the Sunday closest to December 31. All fiscal years presented except for fiscal 2004, which ended January 2, 2005, are 52 weeks. The fiscal year ended January 2, 2005 is 53 weeks. The effect of the additional week in fiscal 2004 was to increase revenues, and gross profit by \$4,116 and \$87, respectively and increase operating loss by \$336.

The fiscal years presented are as follows:

Fiscal Year	Fiscal Year End
2000	December 31, 2000
2001	December 30, 2001
2002	December 29, 2002
2003	December 28, 2003
2004	January 2, 2005

- (2) The Company reversed \$1.4 million in fiscal 2000 of accrued telephone charges originally recorded in the fourth quarter of fiscal 1998. This reversal resulted from the Company negotiating favorable dispositions of costs associated with certain guaranteed minimum usage telecommunications contracts. Excluding this reversal in fiscal 2000 costs of services were \$361.1 million.
- (3) The Company recorded \$2.0 million of restructuring charges in fiscal 2004 related to the closure of three Customer Interaction Centers, the transition of one center to a client and the elimination of certain administrative and support positions. These charges also included severance costs resulting from the elimination of administrative and support positions. Restructuring and other charges in fiscal 2004 also include the reversal of \$0.2 million of prior year charges, which were not utilized. Fiscal 2003 includes restructuring and other charges of \$3.4 million related to the closure of five Customer Interaction Centers and the elimination of certain administrative and support positions and the reversal of \$0.1 million of prior year restructuring charges not utilized. Restructuring and other charges in fiscal 2002 primarily related to the closing of sixteen Customer Interaction Centers, the transition of one center under a facility management contract and the reversal of \$0.3 million related to prior year restructuring charges not utilized. Restructuring and other charges in fiscal 2001 related to the closing of seven Customer Interaction Centers and charges associated with the settlement of litigation and additional bad debt provisions. Fiscal 2000 includes other charges related to costs in the area of people, technology and the move to the new headquarters in Deerfield, Illinois.
- (4) The Company recorded \$2.2 million of asset impairment charges during fiscal 2004 relating to the write-off of unutilized software and telecommunications equipment. Fiscal 2003 asset impairment charges related to the write-off of certain software licenses and computer hardware. Asset impairment charges in fiscal 2002 and fiscal 2001 of \$1.0 million and \$8.6 million, respectively, related to the write-off of certain non-performing IT hardware and software costs and, in 2002, certain telecommunications equipment.
- (5) In January 2000, pursuant to an agreement executed in December 1999, the Company sold the stock of Paragren Technologies, Inc. ("Paragren"). Accordingly, Paragren was reported as a discontinued operation and the consolidated financial statements were reclassified to segregate the net assets and operating results of the business. Fiscal 2000 includes a gain of \$0.5 million, net of \$0.3 million of income tax expense related to the sale of Paragren in January 2000.
- (6) Represents the number of Customer Interaction Centers and workstations in service as of the end of such fiscal year.
- (7) Net revenue per workstation was based on the average number of workstations in service for each of the fiscal years presented.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The Company is a leading provider of customer interaction solutions for market leaders in the communications, financial services, health care, logistics, publishing, insurance and travel and hospitality industries. To help its clients better manage their customer relationships, APAC Customer Services develops and delivers customer care and customer acquisition programs. The Company operates and manages approximately 6,900 workstations in 24 Customer Interaction Centers. The Customer Interaction Centers are managed centrally through the application of telecommunications and computer technology to promote the consistent delivery of quality service. The Company consists of a single operating segment that offers customer interaction solutions to its clients.

The following discussion of the Company's results of operations and liquidity and capital resources should be read in conjunction with the Selected Financial Data and the Consolidated Financial Statements of the Company and related notes thereto appearing elsewhere in this report.

**Results of Operations**

The following table sets forth statements of operations data as a percent of net revenue for the fiscal years ended January 2, 2005, December 28, 2003, and December 29, 2002, (fiscal 2004, fiscal 2003 and fiscal 2002, respectively).

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net revenue:	100.0%	100.0%	100.0%
Operating expenses:			
Cost of services	87.8	81.5	79.7
Selling, general and administrative expenses	14.5	15.1	13.5
Restructuring and other charges	.7	1.0	2.2
Asset impairment charges	.8	.1	.3
	<u>          </u>	<u>          </u>	<u>          </u>
Total operating expenses	103.8	97.7	95.7
	<u>          </u>	<u>          </u>	<u>          </u>
Operating income (loss)	(3.8)	2.3	4.3
Interest expense, net	.1	.3	1.7
	<u>          </u>	<u>          </u>	<u>          </u>
Income (loss) before income taxes	(3.9)	2.0	2.6
Provision (benefit) for income taxes	(1.5)	.7	.9
	<u>          </u>	<u>          </u>	<u>          </u>
Net income (loss)	(2.4)%	1.3%	1.7%
	<u>          </u>	<u>          </u>	<u>          </u>

The Company operates on a 52/53-week fiscal year that ends on the Sunday closest to December 31. All fiscal years presented except for fiscal 2004, which ended January 2, 2005, are 52 weeks. The fiscal year ended January 2, 2005 is 53 weeks. The effect of the additional week in fiscal 2004 was to increase revenues, and gross profit by \$4,116 and \$87, respectively and increase operating loss by \$336.

**Fiscal 2004 Compared to Fiscal 2003**

Net revenue decreased 15.4% to \$273.2 million in fiscal 2004 from \$322.9 million in fiscal 2003, a decrease of \$49.7 million. This decrease is attributable to the decision by Comcast Corporation, a client of the Company, to bring certain marketing programs in-house, a reduction in the mortgage servicing business and reduced customer acquisition volumes related to the impact of the rollout of the Do Not Call registry on October 1, 2003. New business, primarily in the telecommunications sector, and an extra week in fiscal 2004 partially