STARTEK INC
Form 10-Q
November 06, 2007

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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 September 30, 2007

or

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

For the transition period from _____ to _____

Commission file number 1-12793

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

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

(303) 399-2400
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $.01 par value	New York Stock Exchange, Inc.

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filed, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

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

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

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

Common Stock, $0.01 Par Value 14,735,791 shares as of November 1, 2007.

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Part I. FINANCIAL INFORMATION
Item 1. Financial Statements (Unaudited)

STARTEK, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Dollars in thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Revenue	$ 63,169	$ 61,865	$ 179,648	$ 178,495
Cost of services	52,853	52,104	151,885	150,758
Gross profit	10,316	9,761	27,763	27,737
Selling, general and administrative expenses	9,693	7,533	28,125	22,495
Impairment losses and restructuring charges	1,032		4,050	
Operating (loss) income	(409)	2,228	(4,412)	5,242
Net interest and other income	232	337	563	1,403
(Loss) income before taxes	(177)	2,565	(3,849)	6,645
Income tax benefit (expense)	548	(995)	588	(2,114)
Net income (loss)	$ 371	$ 1,570	$ (3,261)	$ 4,531
Net income (loss) per share:				
Basic	$ 0.03	$ 0.11	$ (0.22)	$ 0.31
Diluted	$ 0.03	$ 0.11	$ (0.22)	$ 0.31
Dividends declared per common share	$	$ 0.25	$	$ 0.75

See notes to condensed consolidated financial statements.

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STARTEK, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Dollars in thousands)
(Unaudited)

	As of	
	September 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,057	$ 33,437
Investments	16,350	5,933
Trade accounts receivable, less allowance for doubtful accounts of $36 and $16, respectively	51,087	46,364
Income tax receivable	3,856	1,281
Prepaid expenses	2,442	3,009
Other assets	1,374	
Total current assets	92,166	90,024
Property, plant and equipment, net	57,417	60,101
Long-term deferred tax assets	3,755	4,444
Other assets	1,205	1,166
Total assets	$ 154,543	$ 155,735
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,067	$ 6,061
Accrued liabilities:		
Accrued payroll	6,938	6,798
Accrued compensated absences	5,114	4,146
Accrued health insurance	176	77
Accrued restructuring costs	517	
Other accrued liabilities	623	338
Current portion of long-term debt	4,721	5,654
Short-term deferred income tax liabilities	1,850	754
Grant advances	954	173
Other current liabilities	572	329
Total current liabilities	25,532	24,330
Long-term debt, less current portion	8,316	10,314
Grant advances		781
Other liabilities	2,082	1,928

Total liabilities		35,930		37,353
Stockholders equity:				
Common stock, 32,000,000 non-convertible shares, $0.01 par value, authorized; 14,735,791 and 14,695,791 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively		147		147
Additional paid-in capital		62,429		61,669
Cumulative translation adjustment		2,808		1,222
Unrealized gain on investments available for sale		37		1
Unrealized gain (loss) on derivative instruments		875		(235)
Retained earnings		52,317		55,578
Total stockholders equity		118,613		118,382
Total liabilities and stockholders equity	$	154,543	$	155,735

See notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Operating Activities		
Net (loss) income	$ (3,261)	$ 4,531
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	12,724	12,468
Non-cash compensation expense	760	242
Impairment charge	3,583	
Deferred income taxes	482	(1,528)
Realized gain on investments		(36)
Loss (gain) on sale of assets, or disposal of assets	53	(98)
Changes in operating assets and liabilities:		
Trade accounts receivable, net	(4,230)	(7,258)
Prepaid expenses and other assets	644	348
Accounts payable	(1,624)	143
Income taxes receivable, net	(2,579)	2,992
Accrued and other liabilities	1,719	(604)
Net cash provided by operating activities	8,271	11,200
Investing Activities		
Purchases of investments available for sale	(28,931)	(200,355)
Proceeds from disposition of investments available for sale	18,569	210,604
Purchases of property, plant and equipment	(10,605)	(16,116)
Proceeds from disposition of property, plant and equipment		343
Net cash used in investing activities	(20,967)	(5,524)
Financing Activities		
Proceeds from stock option exercises		1,112
Principal payments on borrowings	(4,191)	(1,888)
Dividend payments		(12,616)
Net cash used in financing activities	(4,191)	(13,392)
Effect of exchange rate changes on cash	507	(439)
Net decrease in cash and cash equivalents	(16,380)	(8,155)
Cash and cash equivalents at beginning of period	33,437	17,425
Cash and cash equivalents at end of period	$ 17,057	$ 9,270

Supplemental Disclosure of Cash Flow Information:				
Cash paid for interest	$	570	$	130
Income taxes paid	$	1,576	$	2,389
Change in unrealized gain on investments available for sale, net of tax	$	36	$	25

See notes to condensed consolidated financial statements.

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

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements reflect all adjustments (consisting only of normal recurring entries, except as noted) which, in the opinion of management, are necessary for fair presentation. Operating results during the three and nine months ended September 30, 2007, are not necessarily indicative of operating results that may be expected during any other interim period of 2007 or the year ending December 31, 2007.

The consolidated balance sheet as of December 31, 2006 was derived from audited financial statements at that date, but does not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the StarTek, Inc. Annual Report on Form 10-K for the year ended December 31, 2006.

Certain reclassifications have been made to 2006 information to conform to 2007 presentation.

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

New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). This Interpretation was effective for our fiscal year beginning January 1, 2007. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires the recognition of penalties and interest on any unrecognized tax benefits. Our policy is to reflect penalties and interest as part of income tax expense as they become applicable. The adoption of FIN 48 had no impact on our consolidated financial statements. We file numerous consolidated and separate income tax returns in the United States federal jurisdiction and in many state jurisdictions, as well as in Canada. Our United States federal returns and most state returns for tax years 2004 and forward are subject to examination. Canadian returns for tax years 2003 and forward are subject to examination. No United States returns are currently under audit and no extensions of statute of limitations have been granted. The 2004 and 2005 Canadian returns are currently under audit by the Canadian Revenue Agency.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (FAS No. 157). FAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating FAS No. 157 and have not yet determined the impact, if any, that the adoption of FAS No. 157 will have on our consolidated results of operations, financial condition or cash flows.

In February 2007, the FASB issued Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Liabilities (FAS No. 159). FAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value, and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new guidance is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the potential impact of the adoption of FAS No. 159 on our financial position and results of operations.

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2. Impairment Losses and Restructuring Charges

In accordance with FAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we evaluate long-lived assets, including property, plant and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amounts of specific assets or group of assets may not be recoverable. In the second quarter of 2007 senior management initiated a comprehensive review of the information technology infrastructure. As a result, for the quarter ended June 30, 2007, we recognized impairment losses of $1,745 related to software projects in process determined to be obsolete. In addition, on July 3, 2007, we announced plans to close our facility in Hawkesbury, Ontario, Canada, by August 30, 2007. As a result of this closure, we impaired $1,273 of facility leasehold improvements in the second quarter of 2007. FAS No. 146, Accounting for the Costs Associated with Exit or Disposal Activities, specifies that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, instead of upon commitment to a plan.

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

As a result of the closure of our Hawkesbury, Ontario, Canada facility, we recorded impairment charges of $565 and restructuring costs of $467 related to lease costs, telephony disconnects and other expenses in the third quarter of 2007. Included in accrued restructuring costs on the Condensed Consolidated Balance Sheet as of September 30, 2007 is $50 of an existing deferred rent liability related to the Hawkesbury facility recorded in previous periods. None of the estimated restructuring charges have been paid as of September 30, 2007.

3. Net Income Per Share

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

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Net income (loss)	$ 371	$ 1,570	$ (3,261)	$ 4,531
Weighted average shares of common stock	14,696	14,696	14,696	14,674
Dilutive effect of stock options	1			41
Common stock and common stock equivalents	14,697	14,696	14,696	14,715
Net income (loss) per basic share	$ 0.03	$ 0.11	$ (0.22)	$ 0.31
Net income (loss) per diluted share	$ 0.03	$ 0.11	$ (0.22)	$ 0.31

Diluted earnings per share is computed on the basis of our weighted average number of common shares outstanding plus the effect of dilutive outstanding stock options and non-vested restricted stock using the treasury stock method. Anti-dilutive securities totaling 763,964 and 710,470 shares in the three and nine months ended September 30, 2007, respectively, and 760,640 and 291,635 shares in the three and nine months ended September 30, 2006, respectively, were not included in our calculation because the stock options exercise prices were greater than the average market price of the common shares during the periods presented.

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4. Investments
As of September 30, 2007, investments available for sale consisted of:

	Basis		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value	
Government debt securities	$	1,000	$	1	$		$	1,001
Corporate debt securities		15,316		43		10		15,349
Total	$	16,316	$	44	$	10	$	16,350

As of September 30, 2007, amortized costs and estimated fair values of investments available for sale by contractual maturity were:

	Within 1 Year		1 - 5 Years		Total		Fair Value	
Government debt securities	$		$	1,000	$	1,000	$	1,001
Corporate debt securities		13,823		1,493		15,316		15,349
Total	$	13,823	$	2,493	$	16,316	$	16,350

The estimated fair value of these investments included gross unrealized losses of $10 and gross unrealized gains of $43. All of the investments in our portfolio as of September 30, 2007 had contractual maturities of one year or less, with the exception of $2,493 with maturities of between 1 and 2 years.
As of December 31, 2006, investments available for sale consisted of corporate debt securities including corporate medium term notes and corporate floating debt with a cost basis of $5,937 and an estimated fair value of $5,933. The estimated fair value of these notes included gross unrealized losses of $4 and no gross unrealized gains. All of the investments in our portfolio as of December 31, 2006, had contractual maturities of one year or less.
We had no investments at September 30, 2007, and December 31, 2006, that had carried unrealized losses for longer than twelve months and no securities were deemed other-than-temporarily impaired during either period. We were not invested in any trading securities as of September 30, 2007 or December 31, 2006.

5. Debt
On June 27, 2007, we amended and renewed our revolving $10,000 line of credit agreement with Wells Fargo Bank, NA (the Bank) effective June 1, 2007. The amendment extends the last day under which the Bank will make advances under the line of credit to June 30, 2009. The tangible net worth we are required to have at December 31, 2006 was amended to $95,000, and must increase (but never decrease) at each subsequent fiscal quarter end by an amount equal to 25% of the net income (but only if positive) for each fiscal quarter then ended. We must generate minimum net profit after taxes of not less than $1.00 on a rolling four-quarter basis, and are not permitted to incur net losses in any two consecutive quarterly periods, nor for the quarter ending March 31, 2008. In determining such profit and loss, we may add back up to $5,000 in non-recurring non-cash charges and up to $5,000 in non-recurring cash charges incurred during the fiscal year ending December 31, 2007. We must maintain unencumbered liquid assets having an aggregate fair market value of not less than $10,000 measured at the end of each fiscal quarter. The outstanding principal balance of the note shall bear interest at either a fluctuating rate per annum 1% below the Prime Rate or at a fixed rate per annum determined by the Bank to be 1.5% above LIBOR. Interest is payable on a monthly basis. No amounts were outstanding under this line of credit as of September 30, 2007 or December 31, 2006. We were in compliance with all of our debt covenants related to this facility as of September 30, 2007 and December 31, 2006.

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6. Principal Clients

The following table represents the concentration of revenue from continuing operations for our principal clients. Please note that in late 2006, two of our clients, AT&T Corp. and Cingular Wireless, LLC, completed a merger, thereby further concentrating our revenue base. As a result, percentages shown in the following table may differ from those previously reported as we have combined the two entities in our calculations below. Revenue concentration by client was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**(1)	**2007**	**2006**(1)
AT&T, Inc. (formerly Cingular Wireless, LLC and AT&T Corp.)	49.0%	50.4%	51.4%	53.7%
T-Mobile, a subsidiary of Deutsche Telekom	22.7%	20.3%	21.0%	21.1%

(1) Data shown above for AT&T, Inc. for 2006 has been adjusted from amounts previously reported on Form 10-Q for Cingular Wireless, LLC and AT&T Corp. due to the recent merger these two clients.

Our contract with Cingular Wireless, LLC (Cingular), now with AT&T, Inc. (AT&T) as a result of its acquisition of Cingular, expired in December 2006. A significant portion of that contract, including the customer care and accounts receivable management portions of the contract, has been extended for the fourth time through November 29, 2007 but has not yet been renewed. The remaining portion of the contract relating to the Cingular business, constituting the business care services portion of the contract, was renewed in December 2006 and expires in November 2008. StarTek entered into a services agreement with T-Mobile for the provision of certain call center services and entered a statement of work with T-Mobile under that services agreement effective October 1, 2007 (the New Agreement). The earlier agreement between StarTek and T-Mobile for call center services dated August 1, 2005, as amended (the Earlier Agreement), was terminated by mutual agreement upon execution of the New Agreement. The Earlier Agreement is the one identified as Exhibit 10.39 in our Form 10-K for the year ended December 31, 2006.

The loss of a principal client and/or changes in timing or termination of a principal client s product launch, volume delivery or service offering would have a material adverse effect on our business, revenue, operating results, and financial condition. To limit our credit risk, management from time to time will perform credit evaluations of our clients. Although we are directly impacted by the economic conditions in which our clients operate, management does not believe substantial credit risk existed as of September 30, 2007.

7. Comprehensive Income

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

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Net income (loss)	$ 371	$ 1,570	$ (3,261)	$ 4,531
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax	679	(47)	1,586	224
Change in fair value of derivative instruments, net of tax	667	(106)	1,110	(80)
Change in unrealized gain (loss) on available for sale securities, net of tax	27	(1)	36	25
Comprehensive income (loss)	$ 1,744	$ 1,416	$ (529)	$ 4,700

We enter into foreign exchange contracts to hedge our anticipated operating commitments that are denominated in foreign currencies. The contracts cover periods commensurate with expected exposure, generally within nine months, and are principally unsecured foreign exchange contracts. The market risk exposure is essentially limited to risk related to currency rate movements. During the three months ended September 30, 2007, these hedging commitments resulted in gross unrealized gains of $1,040. During the nine months ended September 30, 2007, these hedging commitments resulted in gross unrealized gains of $1,754. During the three and nine months ended September 30, 2006, these hedging commitments resulted in a gross unrealized loss of $169 and $127, respectively. These unrealized gains and losses have been recorded in other comprehensive income. These hedging commitments also resulted in $406 and $730 of realized gains during the three and nine months ended September 30, 2007, respectively and $124 and $747 of realized gains during the three and nine months ended September 30, 2006, respectively. These realized gains were recognized in our consolidated statements of income during each respective period.

8. Income Taxes

The year-to-date effective tax rate changed from 31.8% during the first nine months of 2006 to 15.3% in the first nine months of 2007. This change was primarily a result of: (a) a $1,793 tax-basis valuation allowance established in the second quarter of 2007, related to capital loss carryforwards that management does not believe will be offset by sufficient future capital gains before they expire. This valuation allowance reduced net income by $1,793 during the nine months ended September 30, 2007 and reduced basic and diluted earnings per share for the nine months ended September 30, 2007 by $0.12. Approximately $100 of capital gains were generated in the third quarter of 2007 which reduced this tax basis valuation allowance; (b) Tax expense was offset by $364 for the nine months ended September 30, 2007 due to estimated work opportunity tax credits received. No credits were received for the nine months ended September 30, 2006 due to a change in tax law; (c) During the three months ended March 31, 2006, the settlement of an outstanding tax audit allowed us to release $410 of a reserve previously established for this audit. The release of this reserve had a positive effect on basic and diluted earnings per share for the nine months ended September 30, 2006 of $0.03; and (d) During the second and third quarters of 2007, we filed our 2006 state, Federal and Canadian returns, resulting in approximately $692 of adjustments to our estimated tax liability. Adjustments were primarily the result of additional work opportunity tax credits received.

Differences between U.S. statutory income tax rates and our effective tax rates for the nine months ended September 30, 2007 and 2006 were:

	Nine Months Ended September 30,	
	2007	**2006**
U.S. statutory tax rate	35.0%	35.0