TELETECH HOLDINGS INC
Form 10-Q
November 07, 2012
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2012

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 001-11919

TeleTech Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**84-1291044**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9197 South Peoria Street

Englewood, Colorado 80112

(Address of principal executive offices)

Registrant s telephone number, including area code: (303) 397-8100

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 R No o

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

Yes R No o

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

Large accelerated filer o	Accelerated filer R
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 R

As of November 1, 2012, there were 53,714,715 shares of the registrant s common stock outstanding.

Table of Contents

TELETECH HOLDINGS, INC. AND SUBSIDIARIES

SEPTEMBER 30, 2012 FORM 10-Q

TABLE OF CONTENTS

		Page No.
PART I. FINANCIAL INFORMATION		
Item 1.	Financial Statements	
	Consolidated Balance Sheets as of September 30, 2012 (unaudited) and December 31, 2011	1
	Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2012 and 2011 (unaudited)	2
	Consolidated Statement of Equity as of and for the nine months ended September 30, 2012 (unaudited)	3
	Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011 (unaudited)	4
	Notes to the Unaudited Consolidated Financial Statements	5
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	25
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	40
Item 4.	Controls and Procedures	43
PART II. OTHER INFORMATION		
Item 1.	Legal Proceedings	44
Item 1A.	Risk Factors	44
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	45
Item 6.	Exhibits	46
SIGNATURES		47
EXHIBIT INDEX		48

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TELETECH HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(Amounts in thousands, except share amounts)

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 170,377	$ 156,371
Accounts receivable, net	244,175	243,636
Prepaids and other current assets	60,323	37,434
Deferred tax assets, net	15,628	22,994
Income tax receivable	19,879	17,847
Total current assets	510,382	478,282
Long-term assets		
Property, plant and equipment, net	111,431	100,321
Goodwill	72,154	70,844
Contract acquisition costs, net	2,115	2,866
Deferred tax assets, net	34,823	32,512
Other long-term assets	74,699	62,153
Total long-term assets	295,222	268,696
Total assets	$ 805,604	$ 746,978
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 25,053	$ 27,555
Accrued employee compensation and benefits	69,586	71,500
Other accrued expenses	23,723	33,816
Income taxes payable	11,041	10,051
Deferred tax liabilities, net	1,995	912
Deferred revenue	22,766	15,895
Other current liabilities	7,404	10,282
Total current liabilities	161,568	170,011
Long-term liabilities		
Line of credit	88,000	64,000
Negative investment in deconsolidated subsidiary	76	76
Deferred tax liabilities, net	3,248	3,020
Deferred rent	8,565	6,729
Other long-term liabilities	45,228	32,895
Total long-term liabilities	145,117	106,720
Total liabilities	306,685	276,731
Commitments and contingencies (Note 10)		
Stockholders equity		
Preferred stock - $0.01 par value: 10,000,000 shares authorized; zero shares outstanding as of September 30, 2012 and December 31, 2011	-	-

Common stock - $0.01 par value; 150,000,000 shares authorized; 53,712,342 and 56,635,319 shares outstanding as of September 30, 2012 and December 31, 2011, respectively	537	566
Additional paid-in capital	349,131	350,386
Treasury stock at cost: 28,339,911 and 25,416,934 shares as of September 30, 2012 and December 31, 2011, respectively	(404,307)	(357,267)
Accumulated other comprehensive income (loss)	19,123	(5,474)
Retained earnings	520,409	470,776
Noncontrolling interest	14,026	11,260
Total stockholders equity	498,919	470,247
Total liabilities and stockholders equity	$ 805,604	$ 746,978

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TELETECH HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(Amounts in thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Revenue	$ 286,268	$ 304,235	$ 867,720	$ 878,850
Operating expenses				
Cost of services (exclusive of depreciation and amortization presented separately below)	201,766	220,795	622,782	630,274
Selling, general and administrative	43,845	43,445	137,689	138,529
Depreciation and amortization	10,695	11,807	31,040	34,828
Restructuring charges, net	2,440	1,616	20,694	2,298
Impairment losses	161	-	2,958	230
Total operating expenses	258,907	277,663	815,163	806,159
Income from operations	27,361	26,572	52,557	72,691
Other income (expense)				
Interest income	780	896	2,235	2,282
Interest expense	(2,129)	(1,143)	(4,810)	(3,814)
Other income (expense), net	97	(386)	(227)	(647)
Total other income (expense)	(1,252)	(633)	(2,802)	(2,179)
Income before income taxes	26,109	25,939	49,755	70,512
Benefit (Provision) for income taxes	3,611	496	3,030	(9,482)
Net income	29,720	26,435	52,785	61,030
Net income attributable to noncontrolling interest	(1,291)	(1,064)	(3,152)	(2,969)
Net income attributable to TeleTech stockholders	$ 28,429	$ 25,371	$ 49,633	$ 58,061
Other comprehensive income (loss)				
Net income	$ 29,720	$ 26,435	$ 52,785	$ 61,030
Foreign currency translation adjustment	7,358	(16,612)	10,607	(9,731)
Derivative valuation, gross	7,260	(7,104)	21,650	(17,584)
Derivative valuation, tax effect	(2,906)	3,270	(8,480)	7,170
Other, net of tax	298	113	933	334
Total other comprehensive income (loss)	12,010	(20,333)	24,710	(19,811)
Total comprehensive income	41,730	6,102	77,495	41,219
Comprehensive income attributable to noncontrolling interest	(1,357)	(697)	(3,265)	(2,604)
Comprehensive income attributable to TeleTech stockholders	$ 40,373	$ 5,405	$ 74,230	$ 38,615
Weighted average shares outstanding				

Basic		54,093		56,476		55,233		56,790
Diluted		54,905		57,748		55,991		58,173
Net income per share attributable to TeleTech stockholders								
Basic	$	0.53	$	0.45	$	0.90	$	1.02
Diluted	$	0.52	$	0.44	$	0.89	$	1.00

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TELETECH HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders Equity

(Amounts in thousands)

(Unaudited)

	Stockholders Equity of the Company									
	Preferred Stock		Common Stock		Treasury Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Noncontrolling interest	Total Equity
	Shares	Amount	Shares	Amount						
Balance as of December 31, 2011	-	$ -	56,635	$ 566	$ (357,267)	$ 350,386	$ (5,474)	$ 470,776	$ 11,260	$ 470,247
Net income	-	-	-	-	-	-	-	49,633	3,152	52,785
Acquisition of noncontrolling interest	-	-	-	-	-	-	-	-	941	941
Dividends distributed to noncontrolling interest	-	-	-	-	-	-	-	-	(1,440)	(1,440)
Foreign currency translation adjustments	-	-	-	-	-	-	10,494	-	113	10,607
Derivatives valuation, net of tax	-	-	-	-	-	-	13,170	-	-	13,170
Vesting of restricted stock units	-	-	485	5	6,765	(10,802)	-	-	-	(4,032)
Exercise of stock options	-	-	98	1	1,371	(237)	-	-	-	1,135
Excess tax benefit from equity-based awards	-	-	-	-	-	(472)	-	-	-	(472)
Equity-based compensation expense	-	-	-	-	-	10,256	-	-	-	10,256
Purchases of common stock	-	-	(3,506)	(35)	(55,176)	-	-	-	-	(55,211)
Other	-	-	-	-	-	-	933	-	-	933
Balance as of September 30, 2012	-	$ -	53,712	$ 537	$ (404,307)	$ 349,131	$ 19,123	$ 520,409	$ 14,026	$ 498,919

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TELETECH HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Amounts in thousands)

(Unaudited)

	Nine Months Ended September 30, 2012	2011
Cash flows from operating activities		
Net income	$ 52,785	$ 61,030
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	31,040	34,828
Amortization of contract acquisition costs	763	1,448
Amortization of debt issuance costs	531	435
Imputed interest expense	600	649
Provision for doubtful accounts	490	301
Loss (gain) on disposal of assets	180	(351)
Impairment losses	2,958	230
Deferred income taxes	2,134	5,582
Excess tax benefit from equity-based awards	(1,005)	(5,276)
Equity-based compensation expense	10,310	11,563
(Gain) loss on foreign currency derivatives	(574)	966
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	1,091	(26,332)
Prepaids and other assets	(30,893)	(8,939)
Accounts payable and accrued expenses	(15,696)	(28,302)
Deferred revenue and other liabilities	8,697	(8,330)
Net cash provided by operating activities	63,411	39,502
Cash flows from investing activities		
Proceeds from grant for property, plant and equipment	110	2,197
Proceeds from sale of long-lived assets	450	-
Purchases of property, plant and equipment, net of acquisitions	(33,259)	(21,166)
Payment of contract acquisition costs	-	(738)
Acquisitions, net of cash acquired of $1,373 and $14, respectively	(4,809)	(45,787)
Net cash used in investing activities	(37,508)	(65,494)
Cash flows from financing activities		
Proceeds from line of credit	857,650	556,800
Payments on line of credit	(833,650)	(426,500)
Proceeds from other debt	8,014	-
Payments on other debt	(2,783)	(1,646)
Dividends distributed to noncontrolling interest	(1,440)	(2,783)
Proceeds from exercise of stock options	1,135	8,528
Excess tax benefit from equity-based awards	1,005	5,276
Purchase of treasury stock	(55,211)	(58,367)
Payments of debt issuance costs	(432)	(22)
Net cash (used in) provided by financing activities	(25,712)	81,286
Effect of exchange rate changes on cash and cash equivalents	13,815	(4,870)
Increase in cash and cash equivalents	14,006	50,424
Cash and cash equivalents, beginning of period	156,371	119,385
Cash and cash equivalents, end of period	$ 170,377	$ 169,809

Supplemental disclosures

Cash paid for interest	$	3,168	$	2,908
Cash paid for income taxes	$	13,213	$	16,710
Non-cash investing and financing activities				
Purchases of equipment through financing agreements	$	6,100	$	-
Landlord incentives credited to deferred rent	$	1,723	$	-

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TELETECH HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

(1) OVERVIEW AND BASIS OF PRESENTATION

Overview

TeleTech Holdings, Inc. and its subsidiaries (TeleTech or the Company) serve their clients through the primary businesses of Business Process Outsourcing (BPO), which includes data-driven strategic consulting and marketing services, customer management, and hosted and managed technologies, for a variety of industries via operations in the U.S., Argentina, Australia, Belgium, Brazil, Canada, China, Costa Rica, England, France, Germany, Ghana, Italy, Kuwait, Lebanon, Mexico, New Zealand, Northern Ireland, the Philippines, Scotland, South Africa, Spain, Turkey and the United Arab Emirates.

Basis of Presentation

The Consolidated Financial Statements are comprised of the accounts of TeleTech, its wholly owned subsidiaries, its 55% equity owned subsidiary Percepta, LLC, its 80% interest in Peppers & Rogers Group (PRG) and its 80% interest in iKnowtion, LLC which was acquired on February 27, 2012 (see Note 2 for additional information). All intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited Consolidated Financial Statements do not include all of the disclosures required by accounting principles generally accepted in the U.S. (GAAP), pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The unaudited Consolidated Financial Statements reflect all adjustments which, in the opinion of management, are necessary to present fairly the consolidated financial position of the Company as of September 30, 2012, and the consolidated results of operations and comprehensive income and cash flows of the Company for the three and nine months ended September 30, 2012 and 2011. Operating results for the nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

These unaudited Consolidated Financial Statements should be read in conjunction with the Company s audited Consolidated Financial Statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

Certain amounts for 2011 have been reclassified in the Consolidated Financial Statements to conform to the 2012 presentation.

Use of Estimates

The preparation of the Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions in determining the reported amounts of assets and liabilities, disclosure of contingent liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenue and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates including those related to derivatives and hedging activities, income taxes including the valuation allowance for deferred tax assets, self-insurance reserves, litigation reserves, restructuring reserves, allowance for doubtful accounts and valuation of goodwill, long-lived and intangible assets. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ materially from these estimates under different assumptions or conditions. In the three months ended June 30, 2012, the Company recorded a change in estimate which resulted in a decrease of $4.6 million to employee related expenses in connection with an authoritative ruling in Spain related to the legally required cost of living adjustment for our employees salaries for the years 2010, 2011 and 2012.

Table of Contents

TELETECH HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Recently Issued Accounting Pronouncements

In May 2011, the FASB amended its guidance, to converge fair value measurement and disclosure guidance in U.S. GAAP with International Financial Reporting Standards (IFRS). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board. The amendment changes the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The FASB does not intend for the amendment to result in a change in the application of the requirements in the current authoritative guidance. The amendment became effective prospectively for the Company s interim period ended March 31, 2012. The adoption of this guidance did not have a material impact on its financial position, results of operations or cash flows.

In June 2011, the FASB amended its guidance on the presentation of comprehensive income. Under the amended guidance, an entity has the option to present comprehensive income in either one or two consecutive financial statements. The Company decided to present a single statement showing the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income. The amendment became effective retrospectively for the Company s interim period ended March 31, 2012.

In December 2011, the FASB issued additional guidance related to the presentation of other comprehensive income. This guidance is intended to allow the FASB time to re-deliberate whether it is necessary to require entities to present the effects of reclassifications out of accumulated other comprehensive income in both the statement in which net income is presented and the statement in which other comprehensive income is presented. This guidance defers the effective date of only those provisions in the other comprehensive income guidance that relate to the presentation of reclassification adjustments out of other comprehensive income and reinstates the previous requirements to present reclassification adjustments either on the face of the statement in which other comprehensive income is reported or to disclose them in a note to the financial statements. The amendments in this new guidance became effective at the same time as the amendments in the other comprehensive income guidance explained above. The Company s adoption of this standard did not have a material impact on the Company s financial position, results of operations or cash flows.

In July 2012, the FASB issued new accounting guidance that simplifies the impairment test for indefinite-lived intangible assets other than goodwill. The new guidance gives the option to first assess qualitative factors to determine if it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount as a basis for determining whether it is necessary to perform a quantitative valuation test. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning on or after September 15, 2012. The Company will adopt this accounting guidance during the fourth quarter of 2012 and does not expect this adoption to have a material impact on the Company s financial position, results of operations or cash flows.

(2) ACQUISITIONS

OnState

On January 1, 2012, the Company entered into an asset purchase agreement with OnState Communications Corporation (OnState) to acquire 100% of its assets and assume certain of its liabilities for total cash consideration of $3.3 million. OnState provides hosted business process outsourcing solutions to a variety of small businesses. OnState was headquartered in Boston, MA with a minimal employee base.

As of the nine months ended September 30, 2012, the Company has paid $3.1 million of the purchase price. The remaining purchase price will be paid out once the potential for covered losses has expired per the purchase agreement, which is expected to be in 2013. The Company paid $0.1 million of acquisition related expenses as part of the OnState purchase. These costs were recorded in Selling, general and administrative expenses in the accompanying Consolidated Statements of Comprehensive Income during the nine months ended September 30, 2012.

Table of Contents

TELETECH HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The following summarizes the fair values of the identifiable assets acquired and liabilities assumed as of the acquisition date (in thousands):

		Acquisition Date Fair Value
Cash	$	36
Accounts Receivable		68
Property, plant and equipment		33
Software		2,100
Goodwill		1,132
		3,369
Accounts payable		93
		93
Total purchase price	$	3,276

The software acquired will be amortized over four years once it is placed into service. The goodwill recognized from the OnState acquisition is primarily attributable to the synergies resulting from incorporating the acquired software into the Company s current technology platforms in addition to the acquisition of the employees who developed the acquired software. Since this acquisition is an asset acquisition for tax purposes, the goodwill of $1.1 million and software are deductible over their respective tax lives. The acquired goodwill of OnState is reported within the Customer Technology Services segment from the date of acquisition.

iKnowtion

On February 27, 2012, the Company acquired an 80% interest in iKnowtion, LLC (iKnowtion). iKnowtion integrates proven marketing analytics methodologies and business consulting capabilities to help clients improve their return on marketing expenditures in such areas as demand generation, share of wallet, and channel mix optimization. iKnowtion is located in Boston, MA and has approximately 40 employees.

The up-front cash consideration paid was $1.0 million. The Company was also obligated to pay a working capital adjustment equivalent to any acquired working capital from iKnowtion in excess of a working capital floor as defined in the purchase and sale agreement. The working capital adjustment was $0.2 million and was paid during the second quarter of 2012.

The Company is also obligated to make earn-out payments over the next four years if iKnowtion achieves specified earnings before interest, taxes, depreciation and amortization (EBITDA) targets, as defined by the purchase and sale agreement. The fair value of the contingent payments was measured based on significant inputs not observable in the market (Level 3 inputs). Key assumptions included in the fair value calculation include a discount rate of 21% and expected future value of payments of $4.3 million. The $4.3 million of expected future payments was calculated using a probability weighted EBITDA assessment with higher probability associated with iKnowtion achieving the maximum EBITDA targets. As of the acquisition date, the fair value of the contingent payments was approximately $2.9 million. As of September 30, 2012, the fair value of the contingent consideration was $3.4 million, of which $1.0 million and $2.4 million were included in Other accrued expenses and Other long-term liabilities in the accompanying Consolidated Balance Sheets, respectively.

The fair value of the 20% noncontrolling interest in iKnowtion at the date of acquisition was $0.9 million and was estimated based on a 20% interest of the fair value of 100% interest in iKnowtion and was discounted for a lack of control at a rate of 23.1%.

Table of Contents

TELETECH HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In the event iKnowtion meets certain EBITDA targets for calendar year 2015, the purchase and sale agreement requires TeleTech to purchase the remaining 20% interest in iKnowtion in 2016 for an amount equal to a multiple of iKnowtions s 2015 EBITDA as defined in the purchase and sale agreement. These terms represent a contingent redemption feature. The fair value of the redemption feature is based on a comparison of EBITDA multiples and the EBITDA multiple to purchase the remaining 20% of iKnowtion approximates EBITDA multiples in the market for similar acquisitions.

The Company paid $0.1 million of acquisition related expenses as part of the iKnowtion purchase. These costs were recorded in Selling, general and administrative expenses in the accompanying Consolidated Statements of Comprehensive Income during the nine months ended September 30, 2012.

The following summarizes the fair values of the identifiable assets acquired and liabilities and noncontrolling interest assumed as of the acquisition date (in thousands):

		Acquisition Date Fair Value
Cash	$	1,337
Accounts Receivable		1,792
Property, plant and equipment		161
Other assets		90
Customer relationships		1,400