STARTEK INC
Form 10-Q
November 09, 2006

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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, 2006

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 14,695,791 shares as of November 1, 2006.

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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, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Revenue	$ 61,865	$ 53,877	$ 178,495	$ 158,206
Cost of services	52,104	41,353	150,758	121,645
Gross profit	9,761	12,524	27,737	36,561
Selling, general and administrative expenses	7,533	7,190	22,495	21,402
Operating profit	2,228	5,334	5,242	15,159
Net interest and other income	337	1,060	1,403	1,098
Income from continuing operations before income taxes	2,565	6,394	6,645	16,257
Income tax expense	995	2,743	2,114	6,584
Income from continuing operations	1,570	3,651	4,531	9,673
Discontinued operations:				
Loss from operations of discontinued operations		(820)		(1,942)
Income tax benefit		343		732
Loss from discontinued operations, net of tax		(477)		(1,210)
Net income	$ 1,570	$ 3,174	$ 4,531	$ 8,463
Net income per share from continuing operations:				
Basic	$ 0.11	$ 0.25	$ 0.31	$ 0.66
Diluted	$ 0.11	$ 0.25	$ 0.31	$ 0.66
Net income per share including discontinued operations:				
Basic	$ 0.11	$ 0.22	$ 0.31	$ 0.58
Diluted	$ 0.11	$ 0.22	$ 0.31	$ 0.58
Dividends declared per common share	$ 0.25	$ 0.36	$ 0.75	$ 1.08

See notes to condensed consolidated financial statements.

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

	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,270	$ 17,425
Investments	17,995	28,168
Trade accounts receivable, less allowance for doubtful accounts of $4 and $250, respectively	47,870	40,612
Income tax receivable	1,235	4,227
Prepaid expenses	2,054	2,958
Other current assets	76	203
Total current assets	78,500	93,593
Property, plant and equipment, net	61,281	57,066
Long-term deferred tax assets	3,931	2,402
Note receivable	740	740
Deposits	232	113
Other assets	438	
Total assets	$ 145,122	$ 153,914
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,886	$ 4,744
Accrued liabilities:		
Accrued payroll	5,257	7,280
Accrued compensated absences	3,986	3,522
Accrued health insurance	112	462
Other accrued liabilities	300	806
Current portion of long-term debt	2,621	2,551
Short-term deferred income tax liabilities	1,092	1,108
Grant advances	1,184	1,150
Other current liabilities	297	
Total current liabilities	19,735	21,623
Long-term debt, less current portion	1,141	3,099
Long-term deferred rent	1,554	247
Other liabilities	955	781
Total liabilities	23,385	25,750
Stockholders equity:		
Common stock	147	146
Additional paid-in capital	61,627	60,139

Accumulated other comprehensive income		1,945		1,776
Retained earnings		58,018		66,103
Total stockholders equity		121,737		128,164
Total liabilities and stockholders equity	$	145,122	$	153,914

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,	
	2006	2005
Operating Activities		
Net income	$ 4,531	$ 8,463
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	12,468	9,744
Non-cash compensation cost	242	
Deferred income taxes	(1,528)	(943)
Realized (gain) loss on investments	(36)	711
Gain on sale of assets	(98)	(857)
Changes in operating assets and liabilities:		
Sales of trading securities, net		2,940
Trade accounts receivable, net	(7,258)	12,371
Prepaid expenses and other assets	348	416
Accounts payable	143	(3,114)
Income taxes receivable, net	2,992	10,794
Accrued and other liabilities	(604)	(486)
Net cash provided by operating activities	11,200	40,039
Investing Activities		
Purchases of investments available for sale	(200,355)	(633,045)
Proceeds from disposition of investments available for sale	210,604	617,405
Purchases of property, plant and equipment	(16,116)	(7,315)
Proceeds from disposition of property, plant and equipment	343	1,292
Net cash used in investing activities	(5,524)	(21,663)
Financing Activities		
Proceeds from stock option exercises	1,112	295
Principal payments on borrowings	(1,888)	(3,950)
Dividend payments	(12,616)	(16,676)
Proceeds from borrowings		880
Net cash used in financing activities	(13,392)	(19,451)
Effect of exchange rate changes on cash	(439)	451
Net decrease in cash and cash equivalents	(8,155)	(624)
Cash and cash equivalents at beginning of period	17,425	14,609
Cash and cash equivalents at end of period	$ 9,270	$ 13,985

Supplemental Disclosure of Cash Flow Information:				
Cash paid for interest	$	130	$	198
Income taxes paid	$	2,389	$	3,510
Change in unrealized gain on investments available for sale, net of tax	$	25	$	(575)

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, unaudited)

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 unaudited financial statements reflect all estimates and adjustments (consisting only of normal recurring entries, except as noted) which, in the opinion of management, are necessary for fair presentation of the condensed consolidated balance sheets as of September 30, 2006, and December 31, 2005, the condensed consolidated statements of operations for the three and nine months ended September 30, 2006, and 2005, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2006, and 2005. Operating results during the three and nine months ended September 30, 2006, are not necessarily indicative of operating results that may be expected during any other interim period of 2006 or the year ending December 31, 2006.

The consolidated balance sheet as of December 31, 2005, 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, 2005.

Certain reclassifications have been made to 2005 information to conform to 2006 presentation.

Unless otherwise noted in this report, any description of us refers to StarTek, Inc. and our subsidiaries. Unless otherwise indicated, currency translations into U.S. dollars are calculated using prevailing foreign currency exchange rates as of September 30, 2006, for all assets and liabilities of our foreign operations. Revenues and expenses incurred in foreign currencies are translated at the weighted-average exchange rate during the reporting period.

New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS No. 123(R)), which replaces SFAS No. 123, Accounting for Stock Issued to Employees. We adopted FAS No. 123(R) on January 1, 2006. The impact of the adoption of FAS No. 123(R) is discussed in Note 9.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). 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 is effective for fiscal years beginning after December 15, 2006. As such, we will be required to adopt FIN 48 in the first quarter of 2007. We are currently evaluating FIN 48 and have not yet determined the impact, if any, the adoption of FIN 48 will have on our consolidated financial position or results of operations.

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 adoption of FAS No. 157 will have on our consolidated financial position or results of operations.

In September 2006, the U.S. Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB No. 108). SAB No. 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for the purpose of determining if the current year financial statements are materially misstated. In the year of initial adoption, SAB No. 108 permits registrants to record the cumulative effect of initial adoption by recording the necessary correcting adjustments that are material under the dual method to the carrying values of assets or liabilities as of the beginning of that year, with an offsetting adjustment recorded in retained earnings. SAB No. 108 is effective no later than the first fiscal year ending after November 15, 2006. We are currently evaluating SAB No. 108 and have not yet determined the impact, if any, that adoption of SAB No. 108 will have on our consolidated financial position or results of operations.

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2. 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, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
	(in thousands, except per share amounts)			
Net income available to common shareholders from continuing operations	$ 1,570	$ 3,651	$ 4,531	$ 9,673
Loss from discontinued operations		(477)		(1,210)
Net income	$ 1,570	$ 3,174	$ 4,531	$ 8,463
Weighted average shares of common stock	14,696	14,631	14,674	14,628
Dilutive effect of stock options		42	41	48
Common stock and common stock equivalents	14,696	14,673	14,715	14,676
Basic net income (loss) per share:				
Continuing operations	$ 0.11	$ 0.25	$ 0.31	$ 0.66
Discontinued operations		(0.03)		(0.08)
Net income per basic share	$ 0.11	$ 0.22	$ 0.31	$ 0.58
Diluted net income (loss) per share:				
Continuing operations	$ 0.11	$ 0.25	$ 0.31	$ 0.66
Discontinued operations		(0.03)		(0.08)
Net income per diluted share	$ 0.11	$ 0.22	$ 0.31	$ 0.58

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 using the treasury stock method. Anti-dilutive securities totaling 760,640 and 291,635 shares in the three and nine months ended September 30, 2006, respectively, and 727,280 and 555,138 shares in the three and nine months ended September 30, 2005, 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.

3. Investments

As of September 30, 2006, investments available for sale consisted of:

	Basis	Gross Unrealized Gains	Gross Unrealized Losses	Accumulated Interest	Estimated Fair Value
Commercial paper	$ 13,980	$	$	$ 15	$ 13,995
Corporate debt securities	4,013		(15)	2	4,000
Equity securities	(71)	97	(26)		
Total	$ 17,922	$ 97	$ (41)	$ 17	$ 17,995

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As of December 31, 2005, investments available for sale consisted of:

	Basis	Gross Unrealized Gains	Gross Unrealized Losses	Accumulated Interest	Estimated Fair Value
Commercial paper	$ 18,449	$	$	$ 13	$ 18,462
Corporate debt securities	7,995	7			8,002
Equity securities	1,681	45	(22)		1,704
Total	$ 28,125	$ 52	$ (22)	$ 13	$ 28,168

As of September 30, 2006, amortized costs and estimated fair values of investments available for sale by contractual maturity were:

Corporate debt securities maturing within:	Basis	Estimated Fair Value
One year or less	$ 4,013	$ 4,000
Two to five years		
More than five years		
	$ 4,013	$ 4,000
Commercial paper	13,980	13,995
Equity securities	(71)	
Total	$ 17,922	$ 17,995

As of September 30, 2006, equity securities consisted of an exchange-traded fund and a position in a publicly-traded equity security, as well as short positions against both of these securities. As of December 31, 2005, equity securities consisted of exchange-traded funds, mutual funds and publicly-traded equity securities. Corporate debt securities at September 30, 2006, consisted of variable-rate preferred debt securities. Corporate debt securities at December 31, 2005, consisted of corporate bonds and variable-rate preferred debt securities. We had no investments at September 30, 2006, and December 31, 2005, 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, 2006, or December 31, 2005.

From time to time, we purchase or write option contracts to partially hedge against fluctuations in the value of our investment portfolio. All such options are publicly-traded with standard market terms. These options are recorded at fair value with changes in fair value recognized in current period earnings. We do not designate these options as hedging instruments pursuant to Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities. Options have been an immaterial part of our overall investment portfolio and we expect them to continue to be an immaterial part of our overall risk management approach in the future. We were not invested in any options as of September 30, 2006, or December 31, 2005.

4. Principal Clients

The following table represents the concentration of revenue from continuing operations for our principal clients. Please note that the results of operations of our Supply Chain Management Services platform were classified as discontinued operations throughout 2005. Consequently, total revenue used to calculate these percentages has been adjusted accordingly and may differ from amounts previously disclosed in our filings with the Securities and Exchange Commission as well as other financial disclosures. Please refer to Note 6, *Discontinued Operations*, for discussion of management s sale of the Supply Chain Management Services platform.

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Revenue concentration by principal client was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Cingular Wireless, LLC (formerly AT&T Wireless Services, Inc.)	41.2%	51.7%	44.2%	54.3%
T-Mobile, a subsidiary of Deutsche Telekom	20.3%	25.9%	21.1%	23.6%

During the three and nine months ended September 30, 2005, revenue from AT&T Corp. accounted for 10.9% and 11.4%, respectively, of our total revenue from continuing operations. For the three and nine months ended September 30, 2006, AT&T Corp. accounted for less than 10% of our total revenue.

Our agreement with Cingular Wireless, LLC expires in December 2006. We are currently in negotiations with Cingular to extend or renew this contract, but do not have a new signed agreement as of the date of this filing. Our contract with T-Mobile automatically renewed in September 2006 and the contract will expire in August 2007. There are no volume or revenue guarantees associated with either of these contracts.

The loss of a principal client, such as Cingular, 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, 2006.

5. Comprehensive Income

SFAS 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,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income	$ 1,570	$ 3,174	$ 4,531	$ 8,463
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax	(47)	473	224	361
Change in fair value of derivative instruments, net of tax	(106)	743	(80)	743
Change in unrealized gain (loss) on available for sale securities, net of tax	(1)	46	25	(575)
Comprehensive income	$ 1,416	$ 4,436	$ 4,700	$ 8,992

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 six months, and are 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, 2006, these hedging commitments generated a gross unrealized loss of $169. During the nine months ended September 30, 2006, these hedging commitments generated a gross unrealized loss of $127, resulting in an unrealized gain position of $47, net of tax. During the three and nine months ended September 30, 2005, these hedging commitments resulted in a gross unrealized gain of $1,062. These unrealized gains and losses have been recorded in other comprehensive income. These hedging commitments also resulted in $124 and $747 of realized gains during the three and nine months ended September 30, 2006, respectively, and $318 of realized gains during the three and nine months ended September 30, 2005. These realized gains were recognized in our consolidated statements of income during each respective period.

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6. Discontinued Operations

On December 16, 2005, we sold our Supply Chain Management Services platform. In connection with the transaction, we sold all of the inventory, prepaid assets, property, plant and equipment of our Supply Chain Management Services platform to a third party for $5,750. We received approximately $4,700 in cash after certain adjustments at closing, in addition to a 5-year, unsecured $740 note. The terms of the note call for the buyer to make quarterly interest payments to us at a fixed rate of 7% per