StarTek, Inc.
Form 10-Q
November 09, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015
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.)

8200 E. Maplewood Ave., Suite 100	
Greenwood Village, Colorado	80111
(Address of principal executive offices)	(Zip code)

(303) 262-4500
(Registrant's telephone number, including area code)

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 x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 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 x
Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x
As of November 4, 2015, there were 15,586,936 shares of Common Stock outstanding.

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NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including the following:

- certain statements, including possible or assumed future results of operations, in “Management’s Discussion and Analysis of Financial Condition and Results of Operations”;
- any statements regarding the prospects for our business or any of our services;
- any statements preceded by, followed by or that include the words “may,” “will,” “should,” “seeks,” “believes,” “expects,” “anticipates,” “intends,” “continue,” “estimate,” “plans,” “future,” “targets,” “predicts,” “budgeted,” “projections,” “outlooks,” “scheduled,” or similar expressions; and
- other statements regarding matters that are not historical facts.

Our business and results of operations are subject to risks and uncertainties, many of which are beyond our ability to control or predict. Because of these risks and uncertainties, actual results may differ materially from those expressed or implied by forward-looking statements, and investors are cautioned not to place undue reliance on such statements, which speak only as of the date thereof. Important factors that could cause actual results to differ materially from our expectations and may adversely affect our business and results of operations, include, but are not limited to, those items described herein or set forth in Item 1A. “Risk Factors” appearing in our Annual Report on Form 10-K for the year ended December 31, 2014 and this Quarterly Report on Form 10-Q for the quarter ended September 30, 2015. Unless otherwise noted in this report, any description of “us," “we,” or "our," refers to StarTek, Inc. ("STARTEK") and its subsidiaries.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STARTEK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenue	$72,756	$61,438	$199,874	$185,901
Cost of services	69,597	52,393	185,284	162,946
Gross profit	3,159	9,045	14,590	22,955
Selling, general and administrative expenses	9,335	7,503	25,981	23,052
Restructuring charges	889	1,262	3,231	3,504
Operating (loss) income	(7,065)	280	(14,622)	(3,601)
Interest and other (expense) income, net	(421)	362	(758)	216
(Loss) income before income taxes	(7,486)	642	(15,380)	(3,385)
Income tax expense	219	728	569	482
Net loss	$(7,705)	$(86)	$(15,949)	$(3,867)
Other comprehensive income (loss), net of tax:		1		
Foreign currency translation adjustments	47	(582)	58	(657)
Change in fair value of derivative instruments	(682)	(905)	78	227
Comprehensive loss	$(8,340)	$(1,573)	$(15,813)	$(4,297)
Net loss per common share - basic and diluted	$(0.49)	$(0.01)	$(1.03)	$(0.25)
Weighted average common shares outstanding - basic and diluted	15,569	15,400	15,504	15,389

See Notes to Consolidated Financial Statements.

STARTEK, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	As of September 30, 2015 (unaudited)	As of December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$814	$ 5,306
Trade accounts receivable, net	51,537	46,103
Derivative asset	5	48
Prepaid expenses	3,847	2,257
Other current assets	1,352	794
Total current assets	57,555	54,508
Property, plant and equipment, net	33,706	28,180
Long-term deferred income tax assets	1,345	1,429
Intangible assets, net	8,143	2,609
Goodwill	8,995	4,136
Other long-term assets	3,000	2,931
Total assets	$112,744	$ 93,793
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$9,931	$ 10,434
Accrued liabilities:		
Accrued payroll	10,083	5,522
Accrued compensated absences	2,682	2,309
Other accrued liabilities	1,696	3,040
Line of credit	28,384	4,640
Derivative liability	1,132	1,250
Deferred income tax liabilities	1,083	965
Other current liabilities	5,624	3,512
Total current liabilities	60,615	31,672
Deferred rent	3,834	1,593
Long-term obligations under capital leases	6,701	4,264
Other liabilities	652	1,583
Total liabilities	71,802	39,112
Commitments and contingencies		
Stockholders’ equity:		
Common stock, 32,000,000 non-convertible shares, $0.01 par value, authorized; 15,586,936 and 15,414,803 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	156	154
Additional paid-in capital	78,128	76,056
Accumulated other comprehensive loss	(689)	(825)
Accumulated deficit	(36,653)	(20,704)
Total stockholders’ equity	40,942	54,681
Total liabilities and stockholders’ equity	$112,744	$ 93,793

See Notes to Consolidated Financial Statements.

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STARTEK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2015	2014
Operating Activities		
Net loss	$(15,949)	$(3,867)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	9,803	7,629
Gains on disposal of assets	(509)	(182)
Gain on dissolution of subsidiary	—	(413)
Share-based compensation expense	1,376	1,207
Amortization of deferred gain on sale leaseback transaction	(168)	(214)
Deferred income taxes	132	955
Changes in operating assets and liabilities:		
Trade accounts receivable	3,778	(2,328)
Prepaid expenses and other assets	(1,245)	1,873
Accounts payable	(5,076)	(982)
Accrued and other liabilities	4,488	(723)
Net cash (used in) provided by operating activities	(3,370)	2,955
Investing Activities		
Proceeds from note receivable	—	481
Proceeds from sale of assets	982	1,064
Purchases of property, plant and equipment	(6,500)	(9,562)
Cash paid for acquisition of business	(18,326)	—
Cash paid for prior period acquisitions of businesses	(583)	(603)
Net cash used in investing activities	(24,427)	(8,620)
Financing Activities		
Proceeds from stock option exercises	552	39
Proceeds from the issuance of common stock	146	89
Proceeds from line of credit	237,840	111,172
Principal payments on line of credit	(214,096)	(109,672)
Principal payments on long-term debt	(276)	(94)
Principal payments on capital lease obligations	(1,203)	(92)
Net cash provided by financing activities	22,963	1,442
Effect of exchange rate changes on cash	342	(214)
Net decrease in cash and cash equivalents	(4,492)	(4,437)
Cash and cash equivalents at beginning of period	$5,306	$10,989
Cash and cash equivalents at end of period	$814	$6,552
Supplemental Disclosure of Noncash Activities		
Working capital receivable (see Note 2)	$834	$—
Assets acquired through capital lease	$4,840	$—

Assets acquired through leasehold incentives	$2,600	$—

See Notes to Consolidated Financial Statements.

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STARTEK, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2015
(In thousands, except share and per share data)
(Unaudited)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") 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 GAAP 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 for the three and nine months ended September 30, 2015, are not necessarily indicative of operating results that may be expected during any other interim period of 2015 or the year ending December 31, 2015.

During the second quarter of 2015, we revised our business segments in order to better align with our strategic view of the business. Refer to Note 12, "Segment Information," for further information. No changes are needed to historical segment results.

The consolidated balance sheet as of December 31, 2014, included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP. As such, the information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

Unless otherwise noted in this report, any description of "us," "we," or "our," refers to StarTek, Inc. and its subsidiaries. Financial information in this report is presented in U.S. dollars.

Use of Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts included in the financial statements and accompanying notes. Estimates and assumptions are reviewed periodically, and the effects of revisions are reflected in the period they are determined to be necessary.

Recent Accounting Pronouncements

In September 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-16 ("ASU 2015-16"), Simplifying the Accounting for Measurement Period Adjustments. ASU 2015-16 replaces the requirement that an acquirer in a business combination account for measurement period adjustments retrospectively with a requirement that an acquirer recognize adjustments to the provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. ASU 2015-16 requires that the acquirer record, in the same period’s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. For public business entities, ASU 2015-16 is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The guidance is to be applied prospectively to adjustments to provisional amounts that occur after the effective date of the guidance, with earlier application permitted for financial statements that have not been issued. ASU 2015-16 is not expected to have a material impact on our consolidated financial statements.

In August 2015, the FASB issued ASU No. 2015-15, Interest — Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements — Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting ("ASU 2015-15"), which clarifies the treatment of debt issuance costs from line-of-credit arrangements after the adoption of ASU 2015-03. In particular, ASU 2015-15 clarifies that the SEC staff would not object to an entity deferring and presenting debt issuance costs related to a line-of-credit arrangement as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of such arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-15 is not expected to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). ASU 2014-09 amends the guidance for revenue recognition to replace numerous, industry-specific requirements and converges areas under this topic with those of the International Financial Reporting Standards. The ASU implements a five-step process for customer contract revenue recognition that focuses on transfer of control, as opposed to transfer of risk and rewards. The amendment also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The amendments in this ASU are effective for reporting periods beginning after December 15, 2016; however, in July 2015, the FASB agreed to delay the effective date by one year. The proposed deferral may permit early adoption, but would not allow adoption any earlier than the original effective date of the standard. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. We are currently assessing the impact the adoption of ASU 2014-09, including possible transition alternatives, will have on our consolidated financial statements.

2. ACQUISITION

On June 1, 2015, we acquired 100% of the membership interests of Accent Marketing Services, L.L.C. ("ACCENT") pursuant to a Membership Interest Purchase Agreement with MDC Corporate (US) Inc. and MDC Acquisition Inc. ACCENT is a business process outsourcing company providing contact center services and customer engagement solutions across six locations in the U.S. and Jamaica. ACCENT’s data-driven approach helps brands maximize their engagement with consumers and enables brands to influence behavior, all while generating a better return on investment across all customer touch points, including phone, online and social media channels. The results of ACCENT's operations have been included in our consolidated financial statements since the acquisition date. ACCENT's customer engagement agency model and platform complements our Ideal Dialogue practice, significantly enhancing our solution set and commitment to results-driven analytics and customer insights for our clients. Accordingly, we paid a premium for ACCENT, resulting in the recognition of goodwill.

On June 1, 2015, consideration in the amount of $18,326, which included $2,326 of estimated working capital, was funded through borrowings from our secured revolving credit facility. See Note 9, "Debt," for further information. During the third quarter and in accordance with the Purchase Agreement, the working capital calculation was finalized and MDC agreed to refund the Company $834 as a result. This amount is accrued as of September 30, 2015 and has been subsequently collected. The purchase price allocation below reflects the final working capital calculation.

We accounted for the acquisition in accordance with ASC 805, Business Combinations, whereby the purchase price paid was allocated to the tangible and identifiable intangible assets acquired and liabilities assumed from ACCENT based on their estimated fair values as of the closing date. Certain amounts are provisional and are subject to change.

The following summarizes the estimated fair values of the identifiable assets acquired and liabilities assumed as of the acquisition date. These estimates of fair value of identifiable assets acquired and liabilities assumed are preliminary, pending completion of a valuation, and therefore are subject to revisions that may result in adjustments to the values presented below:

	Amount
Cash	$16,000
Working capital adjustment	1,492
Total allocable purchase price	$17,492
Accounts receivable	9,265
Fixed assets	2,860
Prepaid expenses and other assets	334
Customer relationships	5,240

Trade name	850
Goodwill	4,860
Accounts payable	(5,590)
Other accrued expenses and current liabilities	(327)
Total preliminary purchase price allocation	$17,492

The customer relationships and trade name have estimated useful lives of eight and six years, respectively. The goodwill recognized was attributable primarily to the acquired workforce, increased utilization of our global delivery platform and other synergistic benefits. Goodwill of $4,860 was assigned to our Domestic segment.
The amount of ACCENT's revenues and net loss since the acquisition date included in our consolidated statements of operations and comprehensive loss for the three and nine months ended September 30, 2015 were as follows:

	From June 1, 2015 Through September 30, 2015
Revenues	$22,799
Net loss	$(1,012)

The following table presents the unaudited pro forma information assuming the acquisition of ACCENT occurred on January 1, 2014. The unaudited pro forma information is not necessarily indicative of the results of operations that would have been achieved if the acquisition and related borrowings had taken place on January 1, 2014:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues				